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Project Report

BRITISH COLUMBIA FINANCIAL REVIEW:

SUMMARY AND RECOMMENDATIONS

Prepared for

The Honourable Glen Clark
Minister of Finance and Corporate Relations
Government of British Columbia

March 11, 1992

92-03841/

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Executive Summary—Overview

On November 14, 1991, the Honourable Glen Clark, Minister of Finance and Corporate Relations, engaged this firm, assisted by Deloitte and Touche, to undertake an independent review of the Province's finances.

The review reached the following conclusions:

- The Consolidated Revenue Fund deficit for fiscal 1991/92 is $2,462 million, based on current accounting practices. The $1,192 million deficit originally projected in the 1991 budget has increased by $1,270 million.

- This increase in the deficit is due to:

  - A revenue shortfall of $378 million.

  - An expenditure overrun of $289 million.

  - An additional $603 million in adjustments resulting from the review and discussion of the December scorecard with ministry officials.

- Adoption of policies as recommended by the Canadian Institute of Chartered Accountants would increase the current year deficit to $2,600 million.

- The financial situation of the province began to worsen by 1989/90. This deterioration was due to provincial government policies, external economic factors and some specific problems with public sector management. Over each of the three years ending in 1991/92, spending was allowed to grow by an average of 12 per cent per annum. This was in excess of the growth in government revenues. The situation was aggravated by federal cutbacks to shared-cost agreements.

- About $1.5 billion of British Columbia's budget deficit is estimated to be structural. That means renewed economic growth will not be sufficient to balance the budget. Deficits will persist into the future unless strong and extraordinary actions are taken.

- The "Balanced Budget Plan" introduced in the 1991 budget assumed tax increases and significant cuts to existing government programs that were not specified in the May 1991 budget.

- The deficit for the fiscal years 1992/93 and 1993/94 will depend on both economic factors and policy decisions. The forecast, assuming a median

economic outlook and no changes to policies or programs, is almost $2.8 billion for 1992/93 and $3.3 billion for 1993/94. These estimates confirm the existence of a structural deficit requiring exceptional measures to be eliminated.

The review recommends that the following seven steps be taken to reduce the deficit:

- Develop and enforce a fully integrated financial policy frame work for provincial operations. This will require the creation of a strong central agency which reports to Cabinet and has the authority to carry out the financial and policy objectives of an overall operating framework.

- Reduce current program commitments while avoiding general "across the board" cuts. This requires better program evaluation and an aggressive cost-avoidance strategy.

- Redesign key programs to reduce delivery and benefit costs and improve management influence over operations.

- Limit public sector salary increases to near the rate of inflation during the next two fiscal years. Increases in subsequent years should depend on how well the government is doing in reducing the structural deficit and real gains in productivity.

- Improve the productivity of the public service. This means creating an environment which is intolerant of wasteful spending and redesigning programs to make them more effective.

- Strengthen provincial revenue collection efforts. This requires tightening up revenue collection procedures and developing a fair and consistent policy on government fees and other charges.

- Additional revenue will be required especially in light of the federal "off loading" of costs. With the exception of Alberta, personal and corporate tax rates are lower than other provinces. Equity, ability to pay and levies in competitive jurisdictions require consideration as revenue increases occur.

Our final word observes the difficulty in balancing revenues and expenditures over a five year time frame, concluding that the base year deficit appears too large for that to occur. Reducing the annual deficit to zero in four to six years will be an extraordinary feat. Finally, although we concentrate on identification of weaknesses, much that we found was excellent and deserves praise. We have been impressed with the competence and dedication of provincial public servants.

I

Introduction

A. Our Terms of Reference

On November 14, 1991, the Honourable Glen Clark, Minister of Finance and Corporate Relations, announced the engagement of this firm, assisted by Deloitte & Touche, to undertake an independent review of the Province's finances. The objectives of the review are to present an independent assessment of the Province's current finances, financial management and accounting practices, as well as to provide information useful to future decisions on financial management and deficit reduction. In addition to expressing our opinion on the forecast of revenues and expenditures for the year ending March 31, 1992, our Terms of Reference asked that we indicate the fiscal outcomes for the years ending March 31, 1993 and 1994.

Accordingly, the focus of our review of all ministries and the main Crown agencies was on identification of government-wide trends and issues. Because of the scale of the provincial enterprise, we have highlighted individual issues within ministries and provided recommendations and suggestions tailored to their specific circumstances only by way of example.

We were directed to examine a number of specific issues, including:

- Actual personnel usage, with an estimate of the number of full-time equivalents employed on personal service contracts by government ministries.
- The status of loans and repayable advances.
- The adequacy of reserves for contingent liabilities.
- The valuation of assets, including those held for sale or recently sold.

As requested, we also commented upon accounting policies and practices, including the possible adoption of reforms recommended by the Public Sector Accounting and Auditing Committee of the Canadian Institute of Chartered Accountants.

Finally, we made recommendations on:

- Adjustments to the government's financial statements.

- The strengths, weaknesses and opportunities for improvement of the government's financial controls.

- Improvements to enable more efficient and effective delivery of government programs.

The project's steering committee was chaired by Dr. David Emerson, then Chief Executive Officer of the British Columbia Trade Development Corporation, and included: George Morfitt, the Auditor General; Michael Costello, the Deputy Minister of Finance and Corporate Relations; Ritchie McCloy, the Executive Vice President of the Institute of Chartered Accountants of British Columbia; Professor Thomas Gunton of Simon Fraser University; and University of Victoria Dean of Law Professor Maureen Maloney. Each one of them made very useful contributions to the project.

The committee met eight times to facilitate the review and to receive and comment upon successive draft reports. We greatly appreciate their assistance and encouragement.

The steering committee received details of our proposed work plan and offered counsel on the resolution of certain procedural matters. The work plan we employed conformed entirely to that discussed with the steering committee. Deloitte & Touche commented on the overall project plan and read drafts of issue papers and this summary.

We are also deeply appreciative for the support of Alan Barnard, Acting Comptroller General. Mr. Barnard was our contact point on day-to-day matters and also served as steering committee secretary.

This is a hectic time of year for public servants. A new government is settling in and its first budget is being prepared; yet, even so, senior officials of ministries and Crown agencies took the time necessary to meet with us and answer our numerous requests for information. Responsiveness and a sincere desire to help us were the dominant tones of these encounters; and we are most grateful.

B. Our work plan

This project began on November 25, with the first steering committee meeting. Draft reports began being delivered to the steering committee on January 31, 1992. As their comments were received, revisions were made and final reports issued to the Minister of Finance and Corporate Relations on February 26, March 4 and March 10, the day before being made public in each case. The first group contained eight issue papers dealing with financial management and planning. The second was composed of eight issue papers on asset management and planning; while the third set had the issue paper on loans and this summary. Chapters VI and VII summarize the findings and recommendations of all 17 issue papers.

To begin the project, individual files were assembled on each of 47 government ministries and crown agencies. The head of each entity was asked to complete a

questionnaire and provide supporting data. A staff member assigned to each entity reviewed these documents and then met with entity representatives, in most cases the Deputy Minister or the chief executive. Often other staff were also consulted. These meetings and analyses produced further information on each entity. This was the primary basis for our issue papers and this summary report. Copies of preliminary draft summaries were submitted to the head of each entity for comment and correction of factual errors and then to the steering committee. A list of the entities examined in this way is shown in Appendix D.

To avoid conflict of interest resulting from prior engagements carried out by us for the following agencies, Deloitte & Touche conducted the examinations of:

- B.C. Railway Company
- B.C. Transit
- Discovery Foundation
- B.C. Pavilion Corporation
- B.C. Lottery Corporation
- B.C. Systems Corporation

Deloitte & Touche also examined the B.C. Year of Music Society, the Terry Fox Medical Research Foundation, the B.C. Housing Management Commission and the Provincial Rental Housing Corporation. A third accounting firm was retained by us to review the Credit Union Deposit Insurance Corporation, as both firms had a prior engagement with that organization. These five reviews were less extensive than those received by the other 42 entities.

At several points in the process we consulted directly with the Auditor General. We also spoke frequently with the deputy minister of finance and his staff. The Ministry of Attorney General reviewed the reports and made comments on the use and publication of information. It should be noted that under the rules of Cabinet privilege some limitations were put on our access to data contained in submissions and briefing notes to the previous government.

We carried out no field examinations but relied essentially upon information and records provided by senior officials at the head office of each entity. We did, in several instances, examine detailed operating files. We checked relevant data and findings with the most appropriate public servants.

Unless otherwise noted, the statements in this report should be read as covering the period up to the project's starting date of November 25, 1991. In certain cases we have been able to gather information up to January 31, 1992.

II

Consolidated Revenue Fund Forecast of Revenue and Expenditure for the year ending March 31, 1992

A. Applying existing accounting policies

The Province of British Columbia prepares and publishes three principal sets of annual financial statements. They differ with respect to which funds and government-controlled activities are included in the accounts. Least inclusive is the **General Fund**, which reflects the transactions and balances of the main operating accounts of the province. The next level of financial statement is the **Consolidated Revenue Fund**. It combines the General Fund financial statements with Special Funds, the largest of which has been the Budget Stabilization Fund, which was dissolved on April 1, 1991. The most inclusive accounts are called the **Summary Financial Statements.** These reflect the above funds, along with the activities of 19 crown agencies, combined with the equity in unremitted earnings of 22 government enterprises such as the British Columbia Assessment Authority, British Columbia Ferry Corporation and B.C. Hydro and Power Authority.

To provide a view of the current state of finances of the province, a forecast of the revenues and expenditures of the Consolidated Revenue Fund was prepared. This is the fund into which all public money of the government, other than trust funds, must be paid. It includes all expenditures, assets and liabilities of government other than those in trust funds and Crown corporations.

We worked closely with Ministry of Finance and Corporate Relations officials to review their forecasting procedures and prepare the 1991/92 forecast. A separate issue paper on ministry forecasting procedures provides more detail on the forecasting activity.

Against this background, the forecast was prepared of the Consolidated Revenue Fund revenue and expenditures for the year ending March 31, 1992. This forecast assumes that the accounting policies employed in the last fiscal year, ending March 31, 1991, are **continued** in 1992 and employs comparative aggregation of accounts and financial statement presentation methods. The forecast rests on the underlying assumption that there will be no legislative changes to the pattern of revenues and expenditures in the balance of this fiscal year and that the current policies and strategies will continue in force throughout the forecast period. Other assumptions regarding the major components of the forecast are set out in Appendix A to this report.

Based on our examination of the forecast, which we completed on January 31, 1992, in accordance with the applicable guidelines issued by the Canadian Institute of Chartered Accountants, it is our opinion that the assumptions developed by the Ministry officials are suitably supported and provide a reasonable basis for the forecast to year-end. It is also our opinion that the forecast fully complies with the presentation and disclosure standards for forecasts established by the Canadian Institute of Chartered Accountants.

However, because this forecast is necessarily based on assumptions regarding future events, it is understandable that the actual final results for fiscal 1991/92 will vary from the information now available. Some of these variations may be material. Accordingly, we express no opinion as to the effect on the final outcome of events and circumstances occurring subsequent to the date of completion of this examination.

As can be seen in Exhibit I, the new forecast deficit for fiscal 1991/92 is $2.46 billion.

Exhibit I
Consolidated Revenue Fund—Forecast of British Columbia's revenue and expenditures for the fiscal year ending March 31, 1992 ($ millions)

	Forecast	Actual	% change
Revenue	1991/92	1990/91	1992/91
Taxation	$ 9,289	$ 8,956	3.7 %
Natural resources	1,105	1,171	(5.6) %
Fees and licences	1,468	1,315	11.6 %
Investment earnings	145	140	3.6 %
Miscellaneous	190	234	(18.8) %
Contributions from government organizations and enterprises	531	629	(15.6) %
Contributions from the federal government	2,064	1,961	5.2 %
Total revenue	14,792	14,406	2.7 %
Expenditure			
Health	5,558	5,028	10.6 %
Social services	1,974	1,674	17.9 %
Education	4,579	4,058	12.8 %
Protection of persons and property	854	725	17.8 %
Transportation	1,269	1,188	6.8 %
Natural resources and economic development	1,538	1,064	44.6 %
Other	560	506	10.6 %
General government	287	242	18.6 %
Debt servicing	635	531	19.6 %
Total expenditure	17,254	15,016	14.9 %
Deficit	$ (2,462)	$ (610)	403.6 %

Exhibit II presents a reconciliation of the General Fund deficit as presented in the May 1991 provincial Budget Speech, with the above forecast of the Consolidated Revenue Fund deficit.

Exhibit II
Reconciliation of previously announced budget deficit to current forecast of the deficit for the Year Ending March 31, 1992 ($ millions)

Budget announcement of General Fund deficit		$ (395)
Budget Stabilization Fund transfer		(839)
		(1,234)
Privatization Benefits Fund income		42
Budgeted Consolidated Revenue Fund deficit		(1,192)
Major revenue variations from Budget		
Taxation revenue	$ (61)	
Natural resource revenue	(108)	
Contributions from federal government	(221)	
Other changes to revenue	12	(378)
Major expenditure variations from Budget		
Health	(50)	
Social services	(64)	
Education	(6)	
Protection of persons and property	(89)	
Transportation	3	
Other	(83)	(289)
December budget scorecard		(1,859)
Revisions to the forecast in the course of the review		
Provision for loans	(316)	
B.C. Hydro and B.C. Building Corporation dividends	(89)	
Social Services tax	(75)	
Colleges and institutions accrued vacation/sick leave	(36)	
Valuation adjustment - False Creek Land sale	(18)	
Health - reimburse physicians for systems hardware	(17)	
Tobacco tax	(10)	
Other	(42)	(603)
1991/92 Forecast Deficit		$ (2,462)

The forecast of the 1991/92 General Fund deficit provided in the province's Budget Speech in May 1991 was $395 million. When restated to combine the Budget Stabilization Fund and Privatization Benefits Fund with the General Fund to form the Consolidated Revenue Fund, the deficit forecast became $1.2 billion. In a November 14, 1991, press release, the Minister of Finance and Corporate Relations, the Honourable Glen Clark advised that the 1991/92 deficit could climb to an estimated $1.7 billion, from the previous forecast of $1.2 billion. This was subsequently amended to $1.9 billion in the December ministry estimates.

The forecast in Exhibit I report estimates the 1991/92 Consolidated Fund deficit to be $2.46 billion.

The primary factors contributing to the variation of this current forecast from the May 1991 budget estimate are:

- Revenues in the December scorecard are below the original budget by $378 million. The shortfall is primarily a result of reduced taxation and natural resource revenue caused by the weak economy and contributions from the federal government being below budget. The province had budgeted revenues contingent upon success in a Supreme Court of Canada lawsuit in which the federal government applied to maintain the limitation on cost-sharing. However, the Supreme Court of Canada upheld the federal government's 5 per cent limit on the growth of the Canada Assistance Plan payments imposed in 1990/91. This alone accounts for $156 million of the shortfall.

- Expenditures in the December scorecard are estimated to be $289 million higher than the May budget figure. The main functional areas where substantial increases are anticipated are:

  - Health—higher expenditures of $50 million due to increased utilization of payments for health and dental services provided to those receiving social services.

  - Social Services—a net increase of $64 million in expenditures primarily due to demands on income assistance.

  - Protection of Persons and Property—expected increase in expenditures of $89 million resulting from flood relief payments and higher than budgeted expenditures for criminal injury compensation and for the Legal Services Society.

- As a result of our review and discussions with the Ministry of Finance and Corporate Relations, we are in agreement with the ministry that a further $603 million should be added to the deficit. The largest component of this adjustment is the provision for loan losses of $316 million, which resulted from the review of loans and receivables. The Ministry also expects reductions in tax revenues from the Social Services Tax and tobacco tax.

Through our review of ministries and agencies we have also been able to identify the reduction of dividends expected from B.C. Hydro and the B.C. Buildings Corporation. The B.C. Hydro dividend is reduced on the assumption that the Province, acting as a prudent shareholder, would make a reasonable reduction in dividends requested because of the deferred maintenance identified by B.C. Hydro management. The B.C. Building Corporation reduction in dividend brings it to the level normally requested of that agency. We have also identified and reviewed with Ministry staff items of expenditure not yet provided for in the accounts. No doubt more changes will develop as the year draws to a close. But as of the date of completing our review, January 31, 1992 we and the ministry expect the only significant changes to be from unspent 1991/92 appropriations which have lapsed. The amount of these cannot be forecast with accuracy, but they are unlikely to materially alter the newly forecast deficit. We are also aware that the ministry is reviewing a possible error which resulted in the overstatement of property tax revenue for 1990/91 of approximately $100 million. We have not included an adjustment for this in the forecast because it is a correction to the accounts of the prior year.

B. Applying proposed new accounting policies

In Appendix B to this report, we discuss the accounting policy changes for provincial accounts which we recommend be adopted and the need to develop a new reporting model for the province. If these changes to policies are adopted, as recommended by the Canadian Institute of Chartered Accountants, the deficit for 1991/92 would increase by a further $138 million. The following schedule sets out the financial impact of the changes, which are discussed in Appendix B in detail.

	($ millions)		
	Overstated Assets at March 31/92	Unrecorded Liabilities at March 31/92	Effect on 1991/92 Deficit
Unfunded pensions		558	71
Unrecorded grants		70	5
Contingent liabilities and commitments		124	41
Concessionary loans	130		21
	$130	$752	$138

The following schedule shows the impact of the proposed changes on the forecast deficit for 1991/92:

	($ millions)
Forecast deficit applying existing policies	($2,462)
Impact of revision to accounting policies on the 1991/92 year	(138)
Forecast deficit using recommended accounting policies	($2,600)

Further, the **accumulated** net deficiency of the province would increase by a much larger amount because of adjustments relating to prior years. At March 31, 1992 it would be:

	($ millions)
Net deficiency at March 31, 1991	$(3,277)
Forecast deficit using existing accounting policies	(2,462)
	(5,739)
Impact of accounting policy changes on accumulated deficit	
Overstated assets	(130)
Unrecorded liabilities	(752)
Net deficiency at March 31, 1992 reflecting adoption of accounting policy changes	$(6,621)

Further significant changes to accounting policies, if adopted, would increase the forecast deficit for the year and the accumulated deficit. They would result from providing for fiscal agency loans, as suggested by the Auditor General in his January 1992 report. Fiscal agency loans are advances to school districts, hospitals and other agencies to be repaid from future provincial appropriations. This adjustment would increase the deficit for the year by approximately $675 million and the accumulated deficit by $2.8 billion. These adjustments have not been included above because we believe changes to the treatment of fiscal agency loans should accompany changes to the recording of physical assets and the definition of the reporting entity, as discussed in Appendix B to this report.

The fiscal position of the province is substantially worse than the May 1991 budget estimate. The first question to ask is: "How did British Columbia go from a surplus in the Consolidated Revenue Fund in 1988/89 and 1989/90 to formally budgeting for a

deficit of $1.2 billion in May 1991?" Understanding that first decline is important to understanding the subsequent and further erosion.

Briefly, a number of factors, some exogenous to the province, contributed to a decline in the growth rate of provincial revenues, while government spending continued upward at an increasing rate during the spring, summer and fall of 1991. The difference between the respective growth rates of tax revenues and of expenditures has led British Columbia into a fundamental imbalance between revenues and expenditures. This is referred to as a **structural deficit.** A significant structural deficit exists now in this province and will persist into the future, unless strong and extraordinary actions are taken.

III

Factors Influencing British Columbia's Present Fiscal Position

Until recently, British Columbia's conservative fiscal management kept the province in a healthy financial position, with a net tax-supported debt burden among the lowest of any of the Canadian provinces. Over the last two decades, the British Columbia economy diversified through growth in the service sectors, expanding investment ties with the Pacific Rim countries, increasing exports and improvement in the competitive position of the resource-based industries. During 1985 to 1990, these factors contributed to the provincial gross domestic product (GDP) growing by an annual average rate of 3.5 per cent when adjusted for inflation, faster than Canada as a whole.

However, during the 1988/89 fiscal year expenditures began increasing at a faster rate than GDP, and this trend accelerated in 1989/90 and 1990/91. This recent worsening in the fiscal position of the province has led to concern in the investment community. The following is taken from the October 7, 1991, publication, Standard & Poor's Creditweek International:

> *".....the province's budgetary performance has weakened as a result of spending pressures and the economic slowdown. After registering substantial surpluses of more than 10 per cent of revenues in fiscal years 1989 and 1990 (year ended March 31), the operating surplus shrank to 4.3 per cent of revenues in fiscal 1991. At the same time, the net budget balance, including capital expenditures, shifted from surplus to a moderate deficit amounting to 5.2 per cent of revenues."*

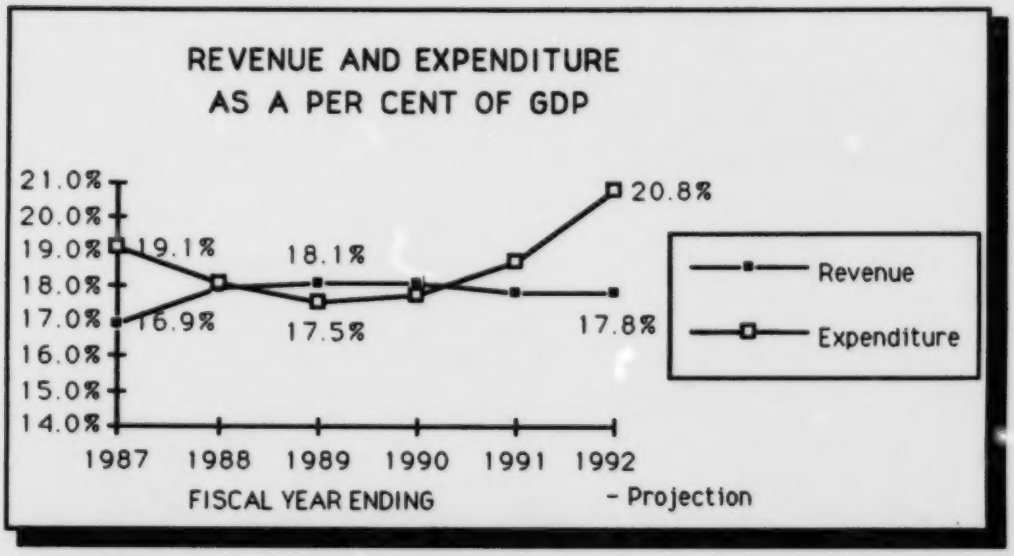
The review went on to state:

> *"In recent years, government expenditures in British Columbia have tended to rise at a faster pace than in other provinces. Budgetary spending has jumped from 17 per cent of GDP in fiscal 1988 to a projected 20 per cent of GDP in fiscal 1991."*

Standard & Poor's is one of the two most eminent credit rating agencies in the United States. The ratings they ascribe are relied on by bond traders around the world when making investment decisions. The recent move of Ontario's AA+ rating by Standard & Poor's to a "credit watch for a possible downgrading" could lead to increased costs and increased difficulty in future financings for Ontario. British Columbia's debt is also rated AA+ by Standard & Poors. While the fiscal position of British Columbia has not deteriorated to the extent of Ontario's, the investment community has noted the trend in

revenues and expenditures and will be monitoring the extent to which control of the province's fiscal position is regained. Since Standard & Poor's October 7 report, new information on the 1991/92 deficit of British Columbia has been released by the government.

The current estimate of the budget deficit using existing accounting policies is, as noted, $2.46 billion. How did we get there? The graph below shows that total expenditures in British Columbia, as a percentage of the province's GDP, began to increase in 1989, while revenues measured in the same manner began to plateau and have recently declined.



Revenues and expenditures have been expressed as a percentage of British Columbia's GDP to adjust for increases in expenditures that result from increased provincial production. By using nominal GDP, the comparison also adjusts for increases in the general level of prices in the province.

The expenditure and revenue trend experienced by British Columbia is not shared by all Canadian provinces. According to a September 1991 report published by the Investment Dealers' Association of Canada, Saskatchewan, Alberta, New Brunswick, Prince Edward Island and Newfoundland are all expected to decrease the size of their budget deficits as a percentage of GDP during 1991/92. The federal government has also managed to gain greater control over increases in the size of its annual deficit. However, much of the federal government's success has come as a result of shifting responsibility for funding more of cost-shared programs to the provincial level, further aggravating British Columbia's problem.

In general, government deficits can be divided into two components:

- A "cyclical" component attributable to fluctuations in economic conditions which will typically be eliminated once the economic cycle turns up again.

- A "structural" component that will persist even if employment and output in the economy returns to "normal" levels.

Although it has other purposes as well, capital spending is a fiscal mechanism of government used to stimulate the economy during an economic downturn. A downturn will also generate more demand for social programs. The culmination of the two will often require deficit financing. When economic conditions improve, the cyclical deficit should be eliminated because of reduced spending by the government on capital projects, fewer pressures on social programs and increased revenues from taxes.

But unlike cyclical budget deficits incurred to stimulate the economy, a structural deficit will not be eliminated without government taking corrective action, such as initiating program cuts and/or taking additional revenue measures.

Of British Columbia's forecast deficit in 1991/92 of $2.46 billion, as much as $1.5 billion was estimated by the Ministry of Finance and Corporate Relations to be attributable to structural factors. The structural component was projected by the Ministry to increase in 1992/93. As the estimated structural component is already close to two-thirds of the total estimated deficit, and is expected to become an even larger portion next year, a return to normal economic activity will not eliminate the deficit.

The growth of this structural deficit, which started in 1989/90, implies that provincial government policy was a primary reason for the increase in that portion of the total deficit. Expenditure growth over the last several years was affected by a number of major provincial government initiatives which, if they are maintained, will continue to impact expenditures over the medium-term. These include:

- Freedom to Move Special Account: $3.5 billion for transportation.

- Social capital reconstruction program: over $2.5 billion in loans to school boards and hospitals over the next three years impacting provincial debt and debt servicing costs.

- Forest Renewal Plan: $1.4 billion for reforestation.

- Royal Commission on Education: $1.4 billion for public school education.

- Science and Technology Fund Special Account: $420 million for science and technology initiatives.

- Universities Matching Fund: $150 million for universities' capital funding.

- "Access for All": $100 million for enhanced post-secondary programs.

- Education financing reform and property tax relief, which resulted in the province assuming a greater share of the cost of public school education.

General Fund spending growth over each of the three years ending in 1991/92 averaged over 12 per cent per annum. Expenditure increases included:

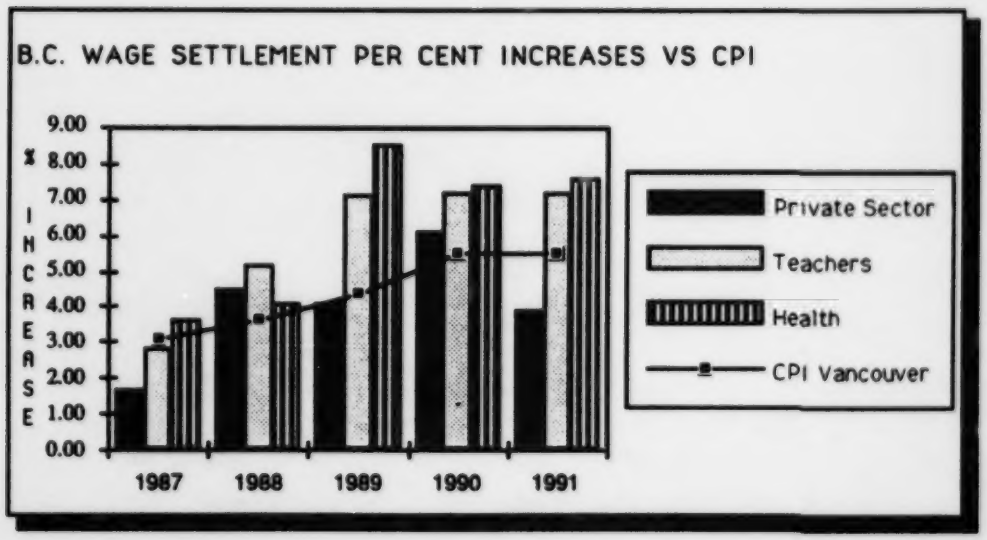
- Increases in health costs of 11.5 per cent on average, due to increased utilization caused by population growth from in-migration and wage increases for health care workers.

- Increases in education costs of 16.9 per cent on average, due to program enrichments, increases in the student population and wage increases.

- Increases in social services costs of 11.0 per cent on average, primarily as a result of a weakening economy and changes in the eligibility requirements for unemployment insurance.

Much of the expenditure pressure has come from wage increases in the public sector. Currently, public sector compensation comprises over 50 per cent of the total provincial budget (direct public service employees, teachers, health care professionals and others).

The following graph tracks wage settlements for health care workers, teachers and the private sector in British Columbia since 1987. These settlements are compared against Vancouver's Consumer Price Index (CPI) during the same period.



"Across the board" public sector salary increases in excess of inflation are a direct and major cost to government. Once incorporated into the base salaries of employees, and the base expenditures of the government the effect is difficult, if not impossible, to off-set.

Each 1 per cent wage increase to public sector employees increases provincial expenditures by $88 million per year. The Ministry of Finance and Corporate Relations estimates that public sector wages account for 53 per cent of all expenditures. With wages at that percentage of total expenditures, we calculate that the excess of public sector increases over wage settlements in the private sector in recent years would account for approximately $800 million of expenditures in the current year. That amount is more than one half of the estimated structural deficit.

It is important to note that not all government employees have been the beneficiaries of significant wage increases. An analysis of wage settlements in government employee groups during the period 1982 through 1990 reveals a compounded salary increase of 71.3 per cent for the Health Employees Union, 63.9 per cent for the British Columbia Nurses Union, 58.6 per cent for teachers, 41.6 per cent for the BCGEU, and only 26.5 per cent for government management employees. Management salaries increased at half the rate of inflation over the period, significantly lower than the salary increases of other employee groups in government.

The deterioration in the province's fiscal position has been aggravated by the slow growth in revenues. Since 1988/89, revenue growth has been affected as economic growth moderated and few new revenue measures were introduced. The tax level in B.C. is now clearly below the average of other Canadian provinces. Revenue growth has also declined as the federal government gradually reduced its share of funding for programs that have previously been fully cost-shared with the provincial government. These reductions have been substantial. Compared to what would have been received had the old cost-sharing continued, revenue from the federal government for the fiscal year 1991/92 was reduced by $1.17 billion. Looking ahead, federal policies will result in federal transfers increasing at a much slower rate than the cost of the shared programs increases.

In the 1991/92 budget introduced in the spring of last year, the Taxpayer Protection Act was announced. Accompanying the Act was a five-year forecast ("The Balanced Budget Plan") of General Fund revenue, expenditure and surplus (deficit). After adjusting for the Budget Stabilization Fund transfer, the forecast anticipated revenues of $15.3 billion for the 1991/92 year and $16.5 billion for 1992/93. This is an estimated increase of $1.2 billion. The plan was to hold revenue at about 18 per cent of GDP over the next few years. It also acknowledged that new taxes would be required if the Province was not successful in getting the federal government to pay their share of the growth in the cost-shared programs. Although not announced, those objectives would have resulted in the need to introduce new measures to raise from $300 to $500 million more revenue.

At the same time the possible need for new revenue measures were put in the Balanced Budget Plan, the government confirmed its commitment to on-going health, education and social services programs. These commitments, combined with the planned small increase in expenditures, implied significant cuts in other government areas. However, these cuts were not specified in the May 1991 budget.

In summary, the Balanced Budget Plan did not discuss in any detail the measures required to achieve its objective; nor were realistic plans presented that could lead the province out of its deficit position.

The combination of wage increases in excess of inflation, the drive to add new programs, the "off loading" by the federal government and a reluctance to announce new revenue programs or develop realistic measures to curtail existing program costs, combined to create the 1991/92 deficit of $2.46 billion, including the structural component of an estimated $1.5 billion. Extraordinary measures by government are necessary to improve this fiscal position. Failure to act will lead to further debt accumulation, with related interest payments consuming an increasing proportion of the provincial budget and adding further to the accumulated budget deficit and to the debt itself.

IV

Consolidated Revenue Fund Deficit Outlook for the years ending March 31, 1993 and 1994

A. Background and methodology

It is not possible to project revenue and expenditures for the years ending March 31, 1993 and 1994 with the same confidence as the forecast for the year ending March 31, 1992. In these times of rapid change, when the boundaries of countries and format of governments are changing around us, there are a number of scenarios which would result in dramatic changes to the financial prospects for British Columbia. For instance, the current dispute with the United States over softwood lumber, the U.S./Canada/Mexico Free Trade Agreement, shifts in exchange rates and a host of other events could affect the pricing of raw materials and the economic outlook of British Columbia. What we are able to do is develop **ranges** of possible changes to revenue and expenditure for the next two years which illustrate the likely consequences **if present revenue and expenditure patterns continue unchanged and the range of predicted changes in major indicators occurs.**

The following schedule of deficit outlooks was prepared on the assumption that the province will continue the accounting policies used for the year ending March 31, 1991. As noted earlier, a number of the policies are not in compliance with those now generally recommended. But using these existing policies facilitates comparison with the forecast results for 1991/92.

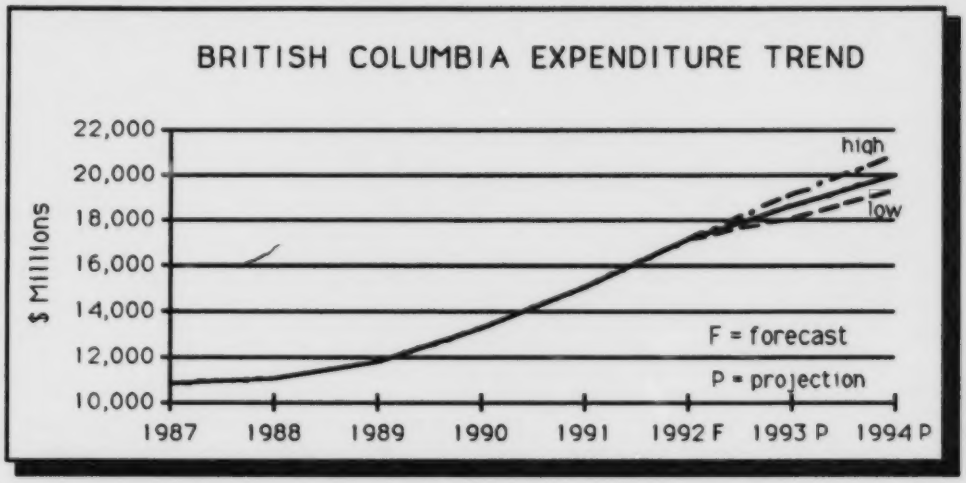
We have completed the forecast calculations assuming that no changes will be made to current programs. We also assumed that the programs will be delivered using existing delivery criteria and that operating costs will only change under the impact of population growth, changes to the level of gross domestic product, wage settlements, interest rates and changes in the consumer price index. Finally, we have assumed that expenditures necessary for the stewardship and effective management of government will be made when they cannot be prudently deferred or avoided. Clearly, the real outcomes will depend very largely on future policy decisions, which have not been taken into account.

The assumptions outlined above mean that the outlook for the next two years depends upon projected levels of change in the major variables affecting the British Columbia economy. The economic variables and the ranges used for each are set out in Appendix C.

To develop the outlook, we dealt separately with health, social services and education because of their relative size compared to total expenditure of the province. Together they represent some 70 per cent of expenditure. We also dealt separately with transportation because, with the exception of the maintenance of existing roads, it relates to new construction and rehabilitation of road networks which is largely discretionary in the short term. These four functional groupings constitute approximately 78 per cent of the total expenditure of the province.

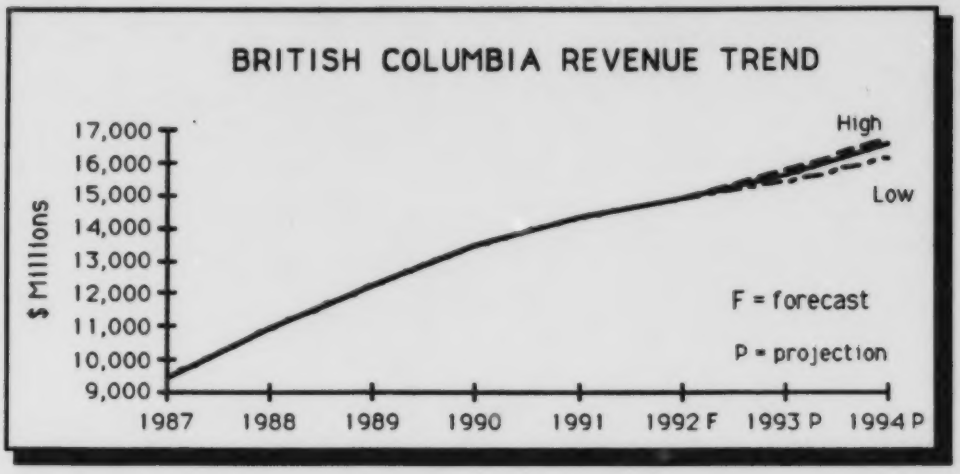
B. Summary of results

The following graph illustrates the actual trend in provincial expenditure since 1987, plus the 1992 forecast and the possible increases occurring in 1993 and 1994.



As can be seen, the median outlook implies a decrease in the rate of growth for provincial expenditure. This is due to the status quo approach we adopted to complete the analysis. In this the estimate for expenditures assumes no new programs and strictly adjusts for the macro-demographic and economic factors previously discussed.

In a similar way, the following graph illustrates the actual trend in provincial revenue since 1987 plus the forecast and possible increases in 1993 and 1994. No new revenue programs are reflected in the graph.



Using the median growth in both revenue and expenditure, we have developed a most likely outlook for the years ending March 31, 1993 and 1994. These outlook results are not what we or the Ministry of Finance and Corporate Relations believe will occur, but what would occur **if the current patterns continue** and no changes are made. We also point out that the changes to revenue and expenditure relate to those forecast for the 1991/92 fiscal year and not the prior year estimates usually published with budget documents.

Consolidated Revenue Fund deficit outlook without new policies for the years ending March 31, 1993 and 1994 ($ millions)

	1993	1994
Forecast deficit for the previous year	$(2,462)	$(2,779)
Median increase in revenue	839	921
Median increase in expenditure	(1,156)	(1,398)
Deficit outlook without new policies for the year	$(2,779)	$(3,256)

As indicated in Appendix C the increase in expenditure in 1993 over 1992 is reduced to account for the "one time" nature of a portion of the provision for loans.

The above table confirms the continued existence of a structural deficit. Even if more optimistic economic forecasts were used than those in our computations a deficit outlook of over $2 billion would result. This reaffirms that exceptional government measures are required to eliminate the structural deficit. This is the scale of the problem the British Columbia government must work to overcome in the coming fiscal year. Let us now turn to how this could be done.

V

Recommendations for a Deficit Reduction Program

In this chapter we summarize our recommendations for coping with the provincial deficit. As noted above, it is estimated that approximately $1.5 billion of the $2.46 billion deficit forecast for 1991/92 is structural and cannot be corrected by an upturn in the economy. Looking ahead, the structural deficit can be expected to continue to increase in 1992/93.

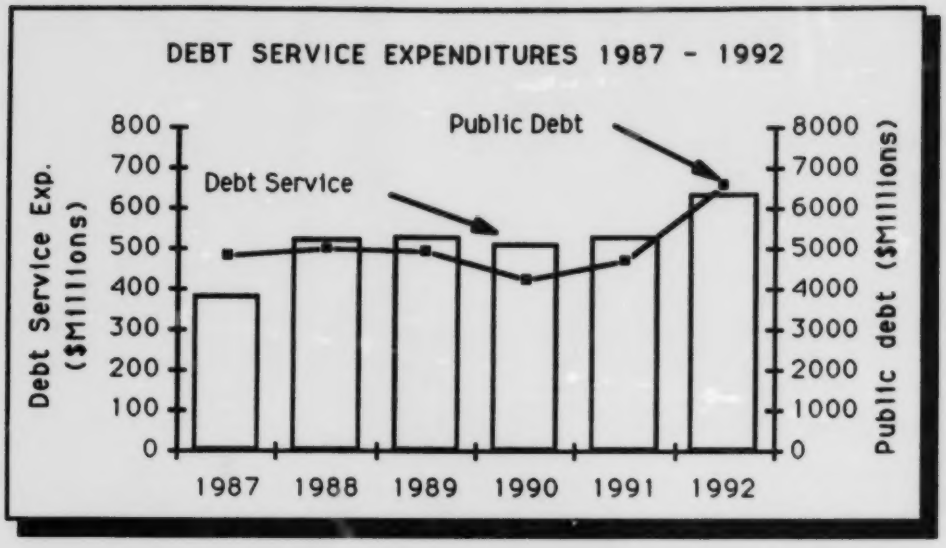
Several of the main factors contributing to this structural deficit, such as reduced federal cost sharing and the loss of tax revenue because of federal policies, are beyond the power of the provincial government to alter.

Accordingly, we limit ourselves to recommendations in those areas over which the province has some direct influence, in the short to medium term. Here we outline a combination of means to increase revenues and decrease expenditures.

We make seven major recommendations. None of these are easy to act upon; but we endorse the government's view that achieving structural deficit reduction is essential to everything else it wishes to accomplish during its mandate. Neither conventional behaviour nor an end to the recession will fully solve this problem.

The cost of ever greater provincial debt is simply too high because it threatens to make interest charges so great as to prevent needed expenditures on health, education and social services. The deficit must be overcome, not as an end in itself but because it is a serious barrier to important social and economic gains.

A look at the current public debt and debt servicing costs confirm that the process must start now. In short, interest charges must be brought down. Each dollar spent on debt service cannot be spent on health care. The following graph displays the increase in public debt and debt service expenditures for 1987 to 1992.



A. Three general strategies

We begin by recommending three general strategies. These are:

- **Start right now, but take the long view**—Deficit reduction must start now; to delay is to make the problem worse. The deficit took several years to create; and full recovery from it will take as long or longer. So a systematic, coordinated and stable program reaching over several years is necessary. The government should establish, make public and then stick to, guiding principles for its fiscal and deficit reduction programs.

- **Diversification**—The province should diversify its deficit reduction strategy, using many different means so as to increase the number of factors potentially contributing to this objective. This will also avoid making any one set of interests or social groups carry a disproportionate share of this burden.

- **Improve equity and fairness in the way the government operates**—Being evenhanded should be an important value for any government, but at this time of restraint and an increasing need to say "no" rather than "yes", it is increasingly important that the government be as equitable as possible in treating its citizens. Unfortunately, we have found a number of examples to the contrary. For example, motor vehicle fines due but uncollected are increasing by $3 million a month and are estimated to reach a total of $45.3 million on March 31, 1992. Overdue court fines were recorded at $51.5 million as of October 31, 1991. A married couple received $117,000 under the Canadian Student Loan Program in the B.C. Student Assistance Program,

and then applied for and received loan remission credit of $54,524. This reduced their combined debt to $62,476, which they were supposed to begin repaying in late 1991. Shortly thereafter, both filed for bankruptcy. In the normal course of events, they will obtain a full discharge of their student loan and other debts in six months. We have also reviewed evidence which suggests the loss of millions of dollars annually by administrative error and fraud in income assistance. A review of the Homeowner Grant Program indicates that grants to ineligible recipients in the range of $2.5 million to $10 million each year are continuing. Tax evasion and avoidance of customs duties are reducing revenue. This is only a sample. Thus, while many pay their fines and loans, many others escape their responsibilities. In short, this government should see to it that we all play by the same set of rules. Otherwise, the sacrifices necessary to reduce the deficit will fall unevenly, only upon some shoulders. Fairness will require more effort and efficiency in managing programs and collecting money owed to the province.

B. Seven specific changes

1. Develop and enforce a fully integrated financial/policy framework for provincial operations

Including Crown agencies, the Government of British Columbia spends about $120 million every day. The provincial administration alone has about 40,000 employees. If this large and complex organization is to achieve deficit reduction objectives, not only must appropriate revenue and expenditure targets be established in the 1992/93 budget at the beginning of the fiscal year, but actual total program design must conform to these budgetary limits. The designs of the most expensive programs such as health care are open-ended and not as responsive as necessary to provincial management. The province must be able to know where these program costs are going, then quickly do what it can to mitigate pressures for increases and reduce other expenditures accordingly. However, no sufficient mechanism exists to bring this about.

There is an absence of adequate management authority to set a budgetary target at the beginning of the year and to **enforce** it each day throughout the year, to its very end. The provincial Treasury Board, which has historically been the agency expected to play this role, does not have the mandate or staff needed to effectively integrate both expenditure and revenue planning, to monitor the on-going program operations which produce the annual expenditures and to directly intervene, as necessary, to keep overall spending on track.

Like the operation of programs, major projects and initiatives can develop into expenditures of much larger proportions than originally planned. The Vancouver Island Gas Pipeline project is a good example of how an initiative can grow in cost to much more than the amount originally expected. Private sector organizations often deal with the problem of being too close to a project to anticipate all the costs

and benefits by commissioning an independent review of major new initiatives. In the present structure it is not clear which arm of government should initiate such reviews nor have we seen criteria developed for them. One possibility is to have the expanded central planning agency described in Chapter VII take responsibility for cost-benefit analyses, using the appropriate technical methods.

Dealing with this deficiency will require the creation of a strong central agency which reports to Cabinet, and has the authority to integrate financial and policy objectives into an overall operating framework. This agency should become the mechanism by which Cabinet ensures that its deficit reduction plan and overall financial plan are in place and influencing the operations of the entire provincial government, from a perspective that regards serving social objectives as important as economic ones. Several other provinces have used such a central authority to considerable advantage.

The previous government attempted to achieve financial management through reliance on several pieces of legislation, including most notably the Taxpayer Protection Act, the Budget Stabilization Fund and the Financial Administration Act. The means to actually carry out budgetary controls were, however, by and large absent. In our view the appropriate financial framework should also involve:

- A requirement for a financial framework covering the entire five-year period 1991-1996, which is reviewed and amended on an annual basis, rather than the present requirement for a rolling five-year plan being prepared each year. The next five years is the period in which deficit control must be re-established. Under the existing structure, for example, the present government in the fourth year of its mandate would be preparing a new five-year plan to 1999, rather than continuing to report on performance in the period November 1991 to November 1996.

- The fiscal framework should incorporate the activity of all Crown-owned corporations and agencies, as well as ministries.

- The financial framework should be expanded to take into account micro as well as macro-level forces that will impact the future fiscal position and direction of the province. This should include consideration of what we call elsewhere "lurking expenditures". It should involve an expansion of the process established in the 1992/93 budget instructions. Its forecast can then be updated by ministries during the summer of 1992 for inclusion in the fiscal framework.

This central agency should also be given a mandate to integrate budget-making and enforcement with overall policy-making and objective-setting as regards social and economic development. It should use a long-term planning horizon, over which the framework would be applied.

2. Reduce current program commitments

Government cannot rectify the structural deficit component and meet its deficit reduction goal without removing some **existing** expenditures. This is distinct from reducing the rate of future expenditure growth. Rather, this involves cuts to the **base** of existing costs. Governments generally have great difficulty doing this, as virtually every dollar now spent has defenders and perceived utility.

We endorse the view that any deficit cutting program will lack public legitimacy and a sense of fairness unless it extends to some cuts in the status quo. More importantly, it will simply fall short.

We have some guidelines to offer on how this can be done with the fewest negative consequences.

- **Either adequately fund or close programs**

  There is a natural tendency to announce new programs, especially those that reflect the interests of the day. This tendency, however, has recently intersected with the growing lack of new funds. The result is a number of new initiatives that are underfunded. Each program requires at least a basic or threshold level of funding. However, if this minimum or threshold amount is not appropriated, the available funding is largely wasted. For example the Hazardous Waste Management Corporation has a 1991/92 allowance of $4.0 million; but according to management, an adequate program will cost about twice that each year. The Sustainable Environment Fund is already facing demands that exceed available resources. This agency has been marked by a continuous series of serious management setbacks. If it is unable to justify and then obtain program funding at a much higher level than is currently the case, it should be closed. The amounts being spent now are simply too small to have a constructive impact on the problem.

  The same is true generally in other programs: as dollars become progressively harder to find, government must either fund specific programs adequately or not at all. The province can no longer afford token amounts that only fund the appearance of initiatives.

- **Avoid "across the board" cuts**

  Avoid general "across the board" fixed-percentage cuts. This approach basically rests on the view that all programs and activities have equal public value; but this is demonstrably not the case. Rather, the appropriate course is to determine **which** expenditures create less crucial public benefits or merely duplicate services provided by other provincial, federal, municipal or private programs. These programs should be stopped. Programs should be prioritized by their measurable

and relative public benefit—a process which recognizes the need to allocate scarce resources to these programs which deliver the most benefit.

- **Limit open-ended initiatives**

  For open-ended initiatives such as:

  Freedom to Move
  Science and Technology Special Account
  Access for All

  government should narrow future commitments and fully budget only the most needed expenditures.

- **Reduce economic development assistance**

  The level of economic development assistance appears to exceed the number of **sound** opportunities turned up by the existing programs. Steps should be taken to increase the number of high-quality development opportunities presented for funding or the funds should be reduced.

- **Back away from long-term, highly variable project commitments**

  The government should also reconsider open-ended commitments, to any long-term and highly variable projects such as the Vancouver Island gas pipeline. A further case in point is the long-term commitment that could be part of the KAON project. The problem here is not the projects so much as it is the commitments to unknown levels of cost.

- **Self finance crown agencies**

  Commercially-oriented Crown agencies should be expected to become fully self-financing.

- **Reduce guarantees and commitments**

  Existing financial guarantees and contingent liabilities for Crown agencies such as B.C. Petroleum Corporation should be reviewed and, as feasible, terminated.

The Province also requires a more vigorous and aggressive **cost-avoidance** strategy. Greater resources should, therefore, be devoted to risk management, forensic accounting and the mitigation of cost pressures and lurking expenditures.

Finally, a new mindset is in order. Anyone with government experience has probably seen instances of "small" potential savings or efficiencies ignored or ridiculed as "rounding errors" and unworthy of corrective action. Over the course of this project we have seen this applied to individual amounts of as much as $10 million. While it is true that the scale of government enterprise must be kept in mind when planning reductions, "small" savings add up. If they are sought and harvested in each of the several hundred parts of the B.C. government, they could easily add up to $100 million a year or more. Until now, however, this idea has not received the backing required to make it persuasive, although the Employees Suggestion Awards Program has generated some worthwhile savings.

3. Redesign programs to reduce costs

The broad outline of a deficit reduction strategy is clear. The target amount likely saved from each method should be identified, e.g., better revenue collection, tax increases, program cuts, etc. These may, however, not yield enough to achieve the objective, so a further set of step may be necessary.

The bulk of provincial expenditures are for two categories of cost. The first is staff salaries and related overhead; the second is program expenditures. A Ministry of Finance and Corporate Relations publication defines a program as: "Any small or large scale organized activity or group of activities, for which a budget is allocated and/or staff expressly assigned, to achieve specific government objectives".

While **all** potential sources must be used, we recommend that the government resolve to make the maximum possible effort to reduce program costs through their redesign, using this as a principal means to close any remaining gap between revenue and expenditures.

Changes in this way can help to:

- Improve program management information and thus the quality of decisions.
- Do a better job of anticipating and controlling cost increases.
- Reduce the transaction costs of program delivery.
- Improve the degree of management control over program entitlements, enrolments, benefit costs and duration of eligibility.

The considerable body of information we collected in the 47 entity reviews makes it clear that substantial changes in certain aspects of the machinery of a number of key programs are required, for the government to recover its financial balance.

The scale of this program re-engineering should be determined by the scale of the additional savings required to achieve annual deficit reduction targets. Our principle recommendation comes in two parts:

- Simply reducing the amount of dollars flowing through existing programs will not produce the level of savings required, without also depriving some of services and for which they are now eligible.

- Rather, the recommended course, should this additional level of reductions become necessary, is to change the design of key programs so they are less expensive, more effectively managed and are still able to meet all legitimate needs.

Here are three examples of what we mean, two in ministries and one in a Crown corporation.

Legal Aid

The skyrocketing costs associated with the current Legal Aid model have justified a closer review of program delivery alternatives. The current structure relies almost exclusively on private lawyers performing work on the basis of a preset tariff. Some staff lawyers may do non-tariff work, such as administrative law. One option for redesigning the Legal Aid system is for the government to maintain a staff of lawyers to do the same work now performed by the private bar. In short, it would mean the introduction of a public defender system. The Ministry of Attorney General speculates that if 95 per cent of the work were handled by staff lawyers, the costs would drop to 50 per cent of the recently increased tariff. However, the ministry also realizes that this program redesign would prompt very spirited opposition.

No-Fault Insurance

The Ministry of Attorney General has estimated that about 25-30 per cent of all non-family Supreme Court civil trials in B.C. are motor vehicle related. While definitive and relevant statistics are difficult to obtain and the variables are so numerous that reliable conclusions are exceedingly difficult to reach, the data provide a useful insight into the caseload and related costs of motor vehicle related court cases.

A Supreme Court statistics project in the Vancouver Registry, which consists of about 55 per cent of the B.C. Registry, was commissioned on January 1, 1984, has continued. The data collected and their analysis indicated the following about motor vehicle bodily injury trials:

- They comprise about 21 per cent of new proceedings, second only to Divorce Act actions.

- They are increasing annually at a faster rate than other top classifications.

- They represent about 53 per cent of the trials set and 41 per cent of all trials heard. The next highest classification is about 12 per cent.

- They have the potential for requiring much judicial time at trial, generally averaging much more than one day of trial time, requiring a very high proportion of available judge years.

Other data obtained from ICBC indicates that the number of writs issued as a proportion of bodily injury claims have increased from about 31 to 37 per cent . Over the period 1985 to 1991, the number of bodily injury claims have grown by nearly 200 per cent.

There is no reason to expect the Vancouver Registry analysis to be significantly different from experience in other B.C. registries. It is therefore reasonable to conclude that the costs of motor vehicle related civil cases comprise something close to 50 per cent of the total cost of all B.C. Supreme Court civil trials—a cost that could be reduced significantly by the adoption of a "no-fault" type of motor vehicle insurance product designed for B.C., but using the experience gained with such no-fault products in other jurisdictions throughout North America and the world.

The potential for cost savings could be substantial, and by significantly reducing:

- Court costs commensurate with the reduction in the number of motor vehicle incidents that would qualify for litigation under new no-fault rules and threshold definitions.

- Pre-trial litigation costs on both sides of the case for incidents that clearly are to be settled by the no-fault product and rules.

- Internal costs of ICBCs claims operation for bodily injury cases that are more easily settled under the no-fault rules.

All of these savings impact the citizens of B.C.: the first through a reduction in the cost of government and the deficit; the others in the form of reduced customer premiums from ICBC which, based on experience in other jurisdictions, could reach 15-20 per cent of present levels.

The study and analysis required to design and implement a no-fault insurance product in a jurisdiction such as B.C. is substantial, but the potential benefits to the government and policyholders are also substantial. We recommend this alternative insurance product be evaluated for B.C.

Rationalize Health Care

The government could consider health care service rationalization where there is duplication of service. For example, it could close smaller hospitals near larger regional centres and consolidated expensive specialized services in regional centres. Also, the government could introduce rostered group practices for interested physicians. Two pilot studies are currently underway in this regard. In these practices, patients are grouped and their risk for service need is rated. A budget focus is determined and physicians are funded for all care for the identified group.

4. Limit public sector salary increases

As noted above, more than 50 per cent of the total provincial expenditure each year goes to pay the salaries of public servants, school teachers, university professors, health care professionals and others. This expenditure is already so large that even a relatively small annual increase contributes disproportionately to further budgetary pressures. Certain specific factors are contributing to the problem. These include the following:

- Many Crown agency salaries are higher than those in the regular public service. There is no effective mechanism for coordinating Crown agency and public service salaries. As a result, Crown agency settlements tend to put continuing upward pressure on those of other public servants.

- Salaries to public school teachers and administrators in some cases exceed those paid to members of university faculties and, as is the case with Crown agencies, are putting upward pressure on the salaries in universities.

- In general, senior managers and Crown agency executives are paid less well, in comparison to their comparably employed colleagues in the private sector. This tends to make it more difficult for ministries and Crown agencies to attract and retain qualified leadership.

- Furthermore, we are advised that some Crown corporations pay management bonuses to help narrow the gap with their private sector equivalents. These are not regularly disclosed, are not guided by any central standards and further exaggerate the already unfavourable comparison between regular public sector senior executives and those in Crown corporations.

Public sector salary increases must be limited to near the rate of inflation during the next two fiscal years. In subsequent years, the rate of built-in spending increases should depend on how well the government is doing in reducing the structural deficit and achieving real gains in productivity.

5. Improve the productivity of the public service

The goal is improving productivity. The first step is to create an environment which recognizes and is intolerant of wasteful behaviour, and then to remove administrative processes which require such behaviour For example, in the early 1980s the Ministry of Social Services purchased 20 group homes for $1 from the defunct Vancouver Resources Board. It then sold these group homes for the same token amount to the B.C. Buildings Corporation. BCBC rented these buildings back to the Ministry of Social Services and maintained them for an annual amount of $580,000.

The Ministry of Social Services is very dissatisfied with the service it is receiving from BCBC and the amount it is paying for rent. Therefore, it is in the process of buying these buildings back from BCBC. The initial selling price identified by BCBC was $7 million but has now been reduced to $4.5 million. Once it has purchased these buildings for $4.5 million, Social Services will transfer them to the Provincial Rental Housing Corporation, which will then rent them back to the Ministry of Social Services and provide maintenance for about $325,000 a year or an annual savings of about $260,000 a year.

In short, $4.5 million will move from one branch of government to another with all the related administrative effort, so that public property can then be transferred to a third branch of the government, but continue to be used by the first branch of the government at a somewhat lower annual rate. This entire complex transaction was apparently necessary in order just to contract with a new maintenance provider at an acceptable rate.

Make programs more effective

Besides cutting waste, improving productivity means making procedures and programs more effective. In a very true sense, the most significant set of decisions the Government of British Columbia makes are the ways it designs programs and the resources it decides to allocate to each of the thousand or more programs that collectively make up government operations. But while it is spending close to $18 billion a year on them, the government has no systematic means of determining the extent to which its programs are in fact achieving their desired outcomes and impacts. Nor does it have any way of determining the degree of public benefit attained by alternative allocations of public dollars.

Ministries and agencies should seek to deliver programs and services in the least costly and most effective way. We recommend the development of program specific output targets and performance measures to provide the yardsticks by which productivity increases can be measured.

The absence of objective information about the efficiency and effectiveness of program performance and about the optimal allocation of dollars across programs to maximize public benefit, are the two most significant structural weaknesses on the

operational side of the government. For example, despite the fact that the income assistance program is now costing British Columbia about $100 million a month, there is little effective information on the comparative utility of the several different programs designed to return people to the workforce. While some good program evaluation has taken place, a review of some of these suggests they are either out of date or too limited in scope to provide the kind of comparative management information required to achieve lower administrative costs.

The development of effective program evaluations focusing on major expenditure areas in health, education and social services can in turn support two additional important steps:

- The development of a sophisticated dollar allocation model, referred to above, to optimize public benefits from the money spent.

- An extensive "re-engineering" of major program delivery systems responsible for the bulk of annual expenditures, if they are found by virtue of the program evaluation to be ineffective in their current design.

Examine the results of decentralization

We also believe extensive decentralization in a number of ministries in the mid to late 1980s has fragmented delivery systems. There are now too many individual single service offices at the local level. Currently, the government operates out of more than 3,500 buildings and over 2.1 million square metres of space around the province. This has created substantial and unmanaged problems with program coordination and integration both locally and regionally.

For example, there are 60 separate provincial government offices in the City of Kamloops, and 68 in the City of Prince George. Evidence provided to us suggests that as the number of offices has grown, the degree of local service integration has declined. At the same time, overhead costs including space, equipment, telecommunications and staffing and supervisory costs have increased. Local consolidation of offices will both increase public convenience and make possible the greater and less costly use of common support services, such as computers, telecommunications and copying equipment. Consolidation will also reduce staffing costs. A similar fragmentation exists among Crown agencies and public bodies, of which there are at least 179.

A project to improve productivity in key program areas is required.

6. Strengthen provincial revenue collection efforts

Our review of revenue collection procedures has led us to conclude that they are inadequate and result in substantial revenue losses, i.e., they fail to collect revenue already due and owing to the province. We have identified steps required to strengthen the incentive for line ministries and Crown agencies to do a better job on

cost recovery. At the moment, revenue collection is governed by a number of control mechanisms essentially designed to restrain expenditures rather than encourage income growth.

Specifically, there are two major areas in which government has not maximized revenue. First and foremost, the appropriate level of attention and resources are not being applied to the assessment and collection of taxes and natural resource rents. The marginal return per revenue assessor or collector is over $400,000. However, few steps are being taken to capitalize on the prospective high yield from hiring additional staff. Furthermore, the systems that support revenue collection are some of the oldest and most decrepit in government. To give them appropriate emphasis, we recommend that significant revenue collection activities be evaluated and managed separately from expenditures, using a net return criterion.

The second opportunity to increase revenue requires the creation of government-wide incentives to:

- Recognize and capitalize on the introduction of appropriate charges for goods and services.
- Adjust current charges and fees to maximize revenue, consistent with program policy objectives.
- Encourage timely disposal of assets surplus to government needs, at a fair price.

Unfortunately, the government does not use a consistent policy to determine how such service fees or charges should be set. If there is to be further reliance on such fees, as we believe inevitable, a consistent policy is required for fairness and equitability. We do not anticipate that such fees would be applied to essential health or social services.

Increasing revenue collection is not simply a matter of economics. It can also have substantial social policy benefits. For example, the Ministry of the Attorney General operates a Family Maintenance Enforcement Program (FMEP), so that obligations under maintenance orders and agreements from any court in Canada can be enforced. This program is operated under contract by a private company. In 1990/91, the FMEP collected $17.2 million or about 55 per cent of the money owed under the orders or agreements being enforced. The program is now at a critical stage. Currently fifteen enforcement teams are handling caseloads of 1,000 each, which is about 30 per cent higher than is manageable. In a number of cases successfully enforced maintenance orders provide a direct saving to the province. They can reduce the payments required under the income assistance program for which federal cost-sharing is going down. Making more staff available can both reduce costs and contribute to parental responsibility.

Another example of where revenue generation could be improved is the B.C. Securities Commission. Entrepreneurs are prepared to pay significant amounts to have certain investigations and approvals carried out in the shortest possible time. However, the Commission is prohibited from hiring the individuals necessary to provide this service, because of expenditure limitations.

It makes no sense to ignore a demand for service where customers are prepared to pay and where revenue in excess of true costs can be earned. A full inventory of all such opportunities should be prepared and action taken upon them, under appropriate guidelines.

7. Increase tax revenue

We have not been asked, nor were we in a position, to estimate with any precision the potential savings achievable through each the above steps. However, deficit reduction will require additional revenue, especially in light of the federal off-loading of costs. This can come from better revenue collection, adding new revenue sources, increasing the rates of existing taxes or adding new ones. Our analysis, which is reported in detail in the issue paper on Revenues and Recoveries, concludes after examining the comparative rates of taxation across the country that British Columbia has some room for tax increases, without a significant decline in interprovincial competitiveness.

With the exception of Alberta, personal and sales tax rates are lower there than in other provinces. British Columbia corporate rates have moved from being among the highest of the Canadian provinces in the late 1970s to among the lowest in the late 1980s.

Introduction of new revenue sources and taxes or the increase of existing tax rates will require careful study to give consideration to all the factors involved. In particular, the Province should consider the ability of taxpayers to meet the new tax burden, the equity of that burden and the competitive position of the Province in relation to the taxes and charges in competing jurisdictions of the global economy. The extent of federal off-loading and the performance of the economy will also have an impact on decisions here.

VI

Other Findings from Issue Papers

Before the end of the 1980s, the province's financial condition began to deteriorate. At the same time, key segments of provincial administration and management began to be adversely affected by the changing economic fortunes. More recently, problems in some of these areas have themselves begun to contribute to the further worsening of financial prospects for the future. They are relevant because of what they tell us about the overall state of the government at the end of 1991 and the beginning of 1992.

Our review produced detailed recommendations on 17 key aspects of the provincial government. How the government chooses to handle these will have a major effect on deficit reduction. We have written issue papers on each of these. Making these changes will mean coordinating activities in areas such as program design, highly complex financial procedures, personnel management, risk management, and changes in the reporting relationship between the provincial government and Crown agencies, all from a consistent, strategic perspective.

1. Accounting Policies

Standards of disclosure for public bodies have been increasing because of the important role they play and the increasingly commercial activities in which they are involved. Financial reporting plays a major function in fulfilling government's duty to be publicly accountable. As the province's financial position began to weaken, the government did not adopt new accounting policies which, although justified by emerging professional standards, would increase the "book value" of the deficit. Adopting recommended policies to deal with unfunded pensions, unrecorded grants, commitments and concessionary loans would add $882 million to the accumulated net deficiency forecast to the end of March 1992. The Auditor General has brought attention to fiscal agency loans which, if removed from the balance sheet, would also increase the deficit.

Sooner or later the province will be influenced to accept new policies and adopt a less confusing reporting entity which includes the activities of all arms of government. Reporting in this way would avoid the confusion that has accompanied the Budget Stabilization Fund. It should recognize the value of the physical assets of the province as well as all of its material liabilities and commitments.

We recommend that the government adopt a number of accounting policies which provide complete disclosure and the most accurate overall picture of the provincial

finances and which will prompt better public administration. Work should commence on the development of a new reporting entity and the expanded disclosure it would entail.

2. Disposal and valuation of assets

With the exception of major asset sales and the policy on property development, asset disposals have been conducted in an orderly and appropriate fashion.

On the other hand, we found these incorrect valuations of physical assets. There may well be others:

- The present value of future income resulting from the False Creek Land sale was overstated by $18.3 million.
- The value of the lots at Duke Point was overstated by $0.5 million.

The province's recent history has been punctuated by asset disposals, followed by intense public debate about the appropriateness of the transaction and the financial return to the Crown. In some cases the agency undertaking the sale on behalf of the province has not achieved its stated objectives on behalf of the government. For instance, the agency undertaking the False Creek land sale did so with the express objective to "limit the uncertainties and residual obligations". The sale agreement it entered into required the province to undertake site clean-up at an unknown cost, now estimated at up to $100 million, which is 60-70 per cent of the present value of the proceeds. In order to avoid future questions and losses, procedures for asset disposal should be strengthened. Serious consideration should be given to centralizing major asset disposal to reduce duplication of effort and to ensuring that established valuation and sale procedures are followed consistently, so that proper value will be recovered.

3. Revenues and recoveries

This concerns the way in which the government raises the revenues necessary to pay for its programs. We conclude that the government's failure to address these issues adequately has contributed to the increasing provincial deficit. Specifically, we found that personal tax revenues have grown while corporate rates have gone down, on a comparative basis with other provinces. Also, insufficient resources and attention have been devoted to revenue collection, resulting in the missed opportunity for millions of dollars in public revenues. British Columbia's tax rates are low relative to other jurisdictions in Canada and there is some "tax room" available to address the province's serious deficit problem.

4. Treasury Function

As the government's financial position deteriorated, increasing demands were placed on the treasury function to maximize the return on the Province's investments and to place debt at the lowest cost to the Province. Due to increased debt management demands the Treasury Division undertook a number of new initiatives. While most of these were successful, the degree of risk the Province was running was intensified by the absence of adequate staff and management resources. This has increased the cost of public debt. If, as we believe, the treasury function plays an increasing role in the government's strategy to reduce its deficit, additional and more specialized resources are necessary. This is in line with our recommendation on increasing provincial revenues. The centralization of Crown agency treasury functions in the Ministry of Finance and Corporate Relations should also occur, subject to a more detailed study and verification of benefits.

5. Federal/Provincial Cost Sharing

The reductions in federal/provincial cost sharing will cost the government about $1.3 billion in 1991/92. Even this does not fully underline the significance of what is happening. These losses tend to occur in the programs where the Province's own expenditures are rising most rapidly, several at 15 per cent a year. Thus, the net effect of the limits on federal cost sharing is not simply to reduce the number of dollars available but also to compound the rapid expenditure growth in critical areas such as income assistance. The withdrawal of federal cost sharing accelerates the cost to the Province by adding to the effect of true program expenditure increases. To give this some scale, the income assistance program now costs about $100 million a month in B.C. Some cost-shared programs are increasing at the rate of 25 per cent a year as a result of increased demand and lost federal dollars. Greater strategic effort is required to restrain the rate of growth in such areas.

Changes in program design to maximize work incentives and the greater integration of economic and social development policies are also recommended to reduce reliance on income assistance.

6. Financial Controls

We found insufficient financial means for effectively managing the province's growing revenues and expenditures. This is caused by:

- Incomplete assessment of spending decisions, which are not made within longer-term, strategic context.
- Limited independent program evaluations and value-for-money reviews conducted by the central agencies.

- Insufficient attention paid to the management and control of revenues, with inadequate enforcement of program rules on the collection of monies owed to the province.

- Inadequate controls over physical assets, such as computers, equipment and vehicles.

- Insufficient resources in the financial function to properly monitor and control all program activities.

- Inadequate financial systems for capturing actual and anticipated financial obligations on a timely basis.

In short, the accounting systems, controls and trained personnel are not adequate to allow the prompt accumulation of financial information with which to monitor spending and management activities on a timely basis. An organized plan is needed to strengthen this area as well as to tie budgets and spending decisions to a strategic financial framework.

7. Financial Legislation

The Province adopted several pieces of legislation—the Taxpayer Protection Act, the Budget Stabilization Fund Act and the Privatization Benefit Fund Act—which on the whole impaired the Province's capacity to accurately report on, control and manage its financial affairs. Our conclusion is that to promote economy, efficiency and effectiveness in government, a new overall framework is needed for reporting and evaluating the financial and operational performance of all government entities. This should include the integration of performance and management information appropriate to the level of expenditure represented by specific programs. Putting this new system in place will require eliminating or amending much of the current financial framework legislation.

We recommend the Taxpayer Protection Act (TPA) be repealed in order to give the Minister of Finance and Corporate Relations and the government the flexibility necessary to consider both revenue and expenditure policies in preparing a balanced budget over the term of this government. In its place, we recommend a requirement to review and amend a balanced budget plan every year over a five-year term. This will encourage responsible reporting to the taxpayers on the government's true full-term financial performance prior to the next provincial election.

We found that the Budget Stabilization Fund has been ineffective in stabilizing the operating revenue of government. Furthermore, the establishment of a special fund proved to be very confusing to the general public. It was used to manipulate the financial results that were quoted with respect to the General Fund. Special funds such as the Budget Stabilization Fund have no impact on the revenues and actual surplus/deficit reported in the Summary Financial Statements of the province, and therefore serve no purpose and should be avoided in future.

The Privatization Benefits Fund Act did ensure that net proceeds from privatization transactions have generally flowed into the Privatization Benefits Fund. However, because of the way in which monies have ended up in the Fund, there has been confusion in the minds of the public as to its purpose. Moreover, if the government accepts our recommendations (made elsewhere) to report its financial condition including Crown agencies, on a consolidated basis, these funds will be reported in the financial position of the government as a whole. Under these conditions, these funds could be retained.

We recommend the Financial Administration Act be amended, or new legislation introduced, to provide more public influence over the financial affairs of Crown agencies and other public bodies.

8. Loans, Accounts Receivable and Guarantees

After 1986 and with increasing frequency over the last two years, the Government of British Columbia had loans that were functionally grants, i.e., loans that once made had a low probability of collection. The province operated a dozen loan programs with loan loss ratios as high as 100 per cent. As a consequence of this and other factors, as our review shows, the Province will be required for fiscal 1991/92 to provide for an additional $316 million in bad debts. Changes between now and the end of the fiscal year may affect the final figure. No doubt a more rigorous review would have resulted in a provision for loss on some of these loans in prior years but it is not practical or appropriate to charge a portion against prior years. Some of these bad debts occurred because the Province quite legitimately accepted reasonable levels of risks at a time of declining economic prospects. On the other hand, in a number from cases, decisions were made on an "ad hoc" basis, sometimes accompanied by considerable involvement of elected representatives. The efficiency and effectiveness of each specific loan program should be evaluated as a matter of urgent priority. Weak programs should be discontinued and loan assessment procedures strengthened substantially. We have provided details on recommended changes to the process of loans and guarantees.

9. Government Services

We have reviewed services provided to government by government organizations, including B.C. Buildings Corporation, B.C. Systems Corporation and the Purchasing Commission. We have concluded that the use of dedicated service corporations has been reasonably effective in the organization and delivery of the services but has left a gap in the overall coordination and setting of standards for the provision of the services involved.

B.C. Buildings Corporation and B.C. Systems Corporation each act as a service supplier. As such they do not put a high priority on the setting of user standards or the control of the resource involved. As a result large line ministries are setting up property management activities and have developed a vast number of different computer systems,

running on different hardware platforms, often within the same ministry. It has, for example, been left to the individual ministries to develop their own information systems, often in isolation of each other. In another example, pilot projects letting ministries handle their own space needs are just now getting underway. This carries with it the potential for creation of a second, parallel system using a ministry's accommodation staff: in some cases, with the Provincial Rental Housing Corporation as property manager. This potential system is emerging because of dissatisfaction with B.C. Buildings Corporation, especially around building maintenance quality and costs. The factors contributing to these examples should be evaluated and necessary changes made. The trend to evolving separate systems should be stopped.

Similarly, the Purchasing Commission has been operating a number of government services and providing purchasing activities while, at the same time, developing a government-wide purchasing strategy and setting standards. This has led to a degree of confusion between its standard-setting role and its function as service provider. Some ministries are keen, and have begun, to determine their own purchasing requirements.

A main conclusion is that it is a mistake to give the agencies providing services a role in setting overall government strategy and in defining needs and standards. Rather, these responsibilities should belong to one or more central agencies. Treasury Board has not been playing this full role to date.

In the long term, efficiency could be served by allowing all ministries to purchase services from the lowest bidder, regardless of source, if attempts to resolve the existing problems are not successful.

10. Forecasting and Fiscal Planning

The forecasting issue report looks at the policies and procedures followed by the province to prepare its budget and deficit/surplus forecasts. The report concludes that the forecasting activity is central to the achievement of effective control over the fiscal plan. The forecasting division of the Ministry of Finance and Corporate Relation achieves a lot with the resources at its disposal but should be strengthened and issues of coordination and management information addressed. The following are areas which require changes:

- The forecasting activity is not well enough coordinated with the activity of the ministries to be fully aware of the "lurking expenditures" and the full range of emerging trends affecting future costs.
- Greater emphasis should be given to the long-term fiscal plan and the impact of current decisions on the long-term objective of deficit reduction.
- More appropriate resources should be made available to deal with the full range of activities of the department.

Forecasting is a central component of a budget control program. Most of this work looks at the macro environment. At the same time a sharper eye must be kept on the "small savings" which can add up to a significant amount. The task requires close cooperation within the division, and with operating arms of government.

11. Lurking Expenditures

Long-term budget reduction, to be successful, requires early and accurate anticipation of potential future expenditures and the development of adequate resources to either avoid or minimize them. For example, there has recently been a significant increase in the number of lawsuits being launched against the government. Avoiding substantial increases in future litigation costs and settlements requires reaction to the legal and financial implications of this trend and the identification of mitigation strategies, such as new statutory instruments.

Similar risks exist in several dozen other areas. Examples include significant increases in the cost of seismic readiness for roads and bridges, the pending end to the Province's ability to obtain low-cost debt through the Canada Pension Plan, the potential for significant pressure on the financial condition of the Workers' Compensation Board because of the increasing importance of "stress-related" occupational injuries, and the cost of the loss on the Vancouver Island gas pipeline.

While we are not in a position to reach a conclusion as to whether the number of these "lurking expenditures" has been increasing, there are dozens of potential demands coming at the Treasury Board. Their actual cost impact for the next five years could easily run into hundreds of millions of dollars or more. Indeed, it could be so great as to make deficit reduction extremely difficult and much more prolonged. Therefore, an appropriate strategy to recognize these potential demands and deal with them is urgently required. At the moment no such strategy or capacity exists.

12. Crown Agency Accountability

The Government of British Columbia has over the past ten years encouraged the growth of Crown agencies. There are at least 179 such agencies, having a total of 16 different types of reporting relationships to the government. There are about 25 such agencies playing a significant role in the affairs of the province. While the formal relationship between many of these agencies and the government requires that the agencies operate at arm's length and without financial support from the government, the government is still responsible to the citizens of B.C. for their ultimate performance.

Furthermore, because a number of these entities are expected to pay dividends into the Consolidated Revenue Fund, their financial performance has a direct impact on provincial revenues and deficits. A number of these Crown agencies receive direct and continuing

subsidies from the government. These include: B.C. Rail, B.C. Ferry Corporation the Discovery Foundation and the Pacific National Exhibition.

On at least two occasions Crown agencies have been instructed to pay "dividends" that were greater than could be justified by their actual financial performance in a given year. In one instance, the "dividend" was an amount that would cause debt to exceed the preset limits. The consequence of this requirement would have been a reduction of these agencies' ability to pay dividends in fiscals 1992/93 and 1993/94.

The continued financial health and vitality of Crown agencies are of central importance to any budget reduction exercise. Our review suggests that, in a number of different ways, some major Crowns may not remain in a healthy enough state in the future to fully meet their obligations to customers without significant increases in charges, service reductions or financial assistance from the Provine; unless changes in service design and operations also occur.

We found clear evidence of insufficient coordination between Crown agencies and the government. These can, in turn, have a negative impact on the province's overall financial performance. We have provided recommendations on the development of a structure so that Crown corporation behaviour is consistent with the province's longer term financial and social objectives.

13. Environmental Costs

Over the past ten years British Columbians, along with their fellow Canadians, have become less and less tolerant of environmental pollution. They have also become more aware of the growing costs to remove contamination and toxic elements from air, soil and water. Unfortunately, our review clearly suggests that the Province is in the very early stages of uncovering, estimating and providing for the financial costs of environmental cleanup. There are roughly 2,000 potentially contaminated provincial sites which have not been assessed. The cleanup costs of the sites known to be contaminated are in the range of $130 million to $325 million. Some proportion of this is not the responsibility of the Province and can likely be collected from others. The range of cleanup costs presently known to which the Province is exposed is between $65 million and $180 million. In total, the cost of the cleaning up the toxic and contaminated sites for which the Province either is directly or could become exposed, between now and the year 2000, could be in the range of $400 million to $500 million.

Unfortunately, the Province has in the past missed some opportunities to establish and enforce the liability for clean-up costs of site owners and as a consequence its future costs will be greater. We note that a renewed effort to complete a toxic site inventory and to assess cleanup costs is now underway.

14. Preventive Maintenance

During the 1980s and into the first year of this decade, preventive maintenance was reduced below a prudent level or suspended altogether by a number of Crown agencies and ministries, apparently in order to reduce expenditures. This step has:

- Created a maintenance "deficit" that could easily be greater than $1 billion.
- Sharply increased future expenditure requirements for both more extensive preventive maintenance and capital replacement.

At a time when it is faced with a significant deficit reduction challenge, the government may be forced in several areas to make larger-than-normal expenditures on facility maintenance to compensate for this deficit and prevent an even greater expenditure in the future. One example of a maintenance deficit is B.C. Hydro. As a consequence of the reduction of preventive maintenance during much of the 1980s, Hydro is now facing a maintenance deficit estimated by its management at $125-$175 million. This can have the effect of reducing Hydro's capacity to pay dividends into the Consolidated Revenue Fund below what it otherwise would have been.

The significance of this preventive maintenance deficit is compounded by the need for the expenditure of hundreds of millions of dollars on roads, bridges, schools, hospitals and sewer and water systems.

15. Personnel, Shadow FTEs and Collective Bargaining

On November 21, 1991, the approved 1991/92 estimates for the number of Full Time Equivalents (FTEs) approved by the provincial government was 27,993. This is often taken as the number of persons working for the provincial government excluding Crown agencies. However, the actual number of people working for the government, paid by the taxpayers and more or less indistinguishable in the way they perform their work for the province, is 37,867. There are three additional categories of personnel which should in fact be counted to reach this total. They are:

- **FTE Exemptions**—These are public servants employed in such places as the Treasury Branch of the Ministry of Finance and Corporate Relations who have been exempted from the FTE totals in order to allow them to be recruited, without increasing the formal limit on employment: **7,900**
- **So called "D-Manuals"**—These are individuals employed on contract but paid through the government payroll system: **528**
- **Personal Service Contract FTEs**—This is an estimate we have compiled by review of the employment contracts in each ministry. These do not include any employees on contract in Crown corporations. Our definition of a personal service contract FTE was based on the following parameters—a

minimum value of $10,000, a minimum length of three months, awarded without competition and awarded to an individual not a company: **1,446**

There are another 2,995 positions which have been in some sense "privatized", but for which the government is the sole and long-term contractor. Including these privatized FTEs makes total employment by the provincial government 40,862. Deleting these privatized FTEs and counting only those working directly under the supervision of the provincial government gives a total of 37,867, about 10,000 above the "official" total of FTE-monitored positions.

The FTE count mechanism is no longer an effective control over the provincial manpower levels. Through exemptions and contract employees the cost control effect is largely avoided. For example, the Ministry of Finance and Corporate Relations, which controls the FTE mechanism, itself has a large number of public servants treated as exempt FTEs. There is no central registry or control point for contract personnel. We recommend the substantial transformation of the personnel control function. In place of the current system, control should be achieved by limiting the actual annual dollar expenditures on staff, regardless of the employment "category" in which they are recruited. This method is also more appropriate to a situation in which the government is striving to control costs and balance the budget.

16. Resource Management

We examined natural resource management issues that have a potentially significant impact on the costs and revenues of the provincial government.

We conclude that information required to properly manage provincial resources has not always been produced, resulting in some important decisions which are not fully informed. The Province will have to incur additional costs to develop adequate resource inventory information. Also, resource revenues in a number of areas should be reviewed to determine the appropriateness of the returns.

Forests appear to be harvested at about the maximum sustainable level. Industry and government should look carefully at intensive silviculture, higher value added and better integrated resource management.

Setting aside lands for urban developments, parks and aboriginal land claims will affect government costs and revenues in a number of ways that should be anticipated. There are other provincial resources not yet being managed on a fully integrated basis. The report recommends the development of an integrated resource management strategy.

17. Structure and Process of Financial and Policy Management

We evaluated the government's capacity to combine revenue and expenditure decisions in the annual budgetary process, with its overall policy goals. Having this capacity at the centre of government is essential to support Cabinet policy decisions which impact on deficit reduction.

The current process is inadequate because:

- There is no coordinated policy development, planning and financial management capacity serving government as a whole.
- There is no systematic research and analytical support for Cabinet-level policy formulation.
- Financial issues tend to be dealt with in isolation.

We concluded that:

- The staff support for the Treasury Board Committee of Cabinet must be significantly strengthened, its perspective widened and its role made more aggressive and strategic.
- A new staff capacity in support of the Cabinet Planning Board is required.
- The relationship between the financial and policy planning activities must be coordinated both during budget preparation and throughout the year.

To fulfil its enhanced role Treasury Board and its associated economic policy functions should be established as a distinct entity headed by a public servant with deputy minister status.

There are three ways in which Treasury Board can then be combined with the new policy and planning capability. One way is to set up a single, integrated agency that has budget and planning in one place. A second is to have two agencies, with separate heads reporting to a single public servant. A third is to have two agencies, each reporting to the chairs of their respective Cabinet Committees. In either the second or third option, the deputy minister to the Premier could provide coordination between the two bodies.

On balance we prefer the first alternative, although the other two could successfully meet the objectives outlined above.

We also note the importance of regular program evaluations becoming the responsibility of the new structure. Evaluations should focus on those major programs through which the bulk of provincial expenditures are made.

VII

Summary of Recommendations

In this chapter, we summarize the **recommendations** contained in the 17 issue papers.

1. Accounting Policies

- ► Improve public disclosure by consolidating all the activities of government, both Crown agencies and ministries, into one financial statement.

- ► Amend the accounts of the province to include, on the balance sheet, the liabilities relating to:

  - unfunded pensions—$558 million.
  - unrecorded grants—$70 million.
  - contingent liabilities and commitments—$124 million.

- ► Reduce the carrying value of concessionary loans (those with below normal interest rates) to their true financial value by a writedown of $130 million.

- ► Give further consideration to:

  - incorporating physical assets such as buildings, equipment and vehicles on the balance sheet, and

  - removing fiscal agency loans from the balance sheet.

- ► Provide, in future financial statements, for the ongoing cost of pension benefits earned.

- ► Give better disclosure on commitments and "lurking expenditures".

- ► Distinguish between capital and operating expenditures in both the Estimates and in the Public Accounts.

2. Disposal and Valuation of Assets

- Reduce the carrying value of future sale proceeds from Concord Developments resulting from the sale of False Creek land by $18.4 million to reflect reductions in the expected proceeds from participation in the development as well as discount rates on the note receivable.

- Centralize the disposal function for significant assets in several main categories, i.e., land, buildings and equipment.

3. Revenues and Recoveries

- Make a separate government-wide annual plan for revenue activities, encouraging:

  - efficient revenue collection processes.
  - the adequacy of staff to optimize collection activities.
  - maximization of charged revenue for discretionary services.
  - increasing charges to their true costs.

- To obtain better flexibility, the government should seek federal/provincial arrangements relating to corporate and personal income tax.

- Tailor any additional taxing measures to maintain the competitiveness of the British Columbia economy.

- Make administrative and legislative changes to reduce Social Services Tax and Property Tax slippage due to bad debts, low interest rates and poor enforcement.

- Initiate steps to reduce smuggling and illegal activities, especially those that evade tobacco and liquor taxes.

- Maintain future flexibility of expenditures by avoiding the dedication of tax revenue to specific purposes or the transfer of taxing authority to other levels of government.

- Continue review of the forest tenure system to develop a system that satisfies the legitimate needs of the forest industry while providing the government with more flexibility, revenue and resources for silviculture.

- Study the overall economic rent the province should receive from mineral developments and other natural resources in the light of the contribution of the

mining industry to the economy of the province, environmental risk, economic development assistance required and future infrastructure demands.

- Treat water as a more valuable provincial resource to be inventoried and managed and to produce revenue commensurate with its importance. This implies greater efforts to protect and husband this resource.

- Implement monitoring and collection procedures to ensure greater collection of fines, penalties and miscellaneous charges. Minimum quarterly recovery targets should be set and achieved.

- Ensure that fees charged for government services reflect the cost of those services.

- Develop a common policy on the setting of fees, and revise financial controls to provide incentives for revenue generation.

- Give the Ministry of Finance and Corporate Relations a greater role in revenue collection.

4. Treasury Function

- Increase the staff, systems and risk management resources of Treasury Branch, so they are commensurate with the increasing challenge of administering the multitude of financial instruments with which the department deals.

- Consolidate Treasury functions of the main Crown agencies in the Ministry of Finance and Corporate Relations, after suitable study.

5. Federal/Provincial Cost Sharing

- The province should consider the redesign of cost-shared programs to reduce its exposure to increased program costs not matched by federal contributions.

- The province should seek an agreement guaranteeing stability of federal cost-sharing, or it should take steps to become less reliant on this source of support.

- If these steps are not successful, the province should take steps to limit the obligations to the third parties it funds in a manner consistent with the federal government's reduction of cost-sharing to the provinces for these programs.

6. Financial Controls

- Budgets and operating plans should be set within an appropriate strategic financial framework where they are tied to specific program goals, demonstrable objectives and measurable outcomes.

- The Estimates should be expanded to include Crown corporations and all significant agencies of government for presentation to Cabinet and the Legislative Assembly.

- Budgets should be prepared looking to future years with the facility for multi-year funding of major capital projects and the carry forward of say, 3 per cent of operating expenditures within a ministry from year to year to recognize that agencies and ministries are continuing activities.

- Accountability by ministries and Crown agencies should be increased through reporting on their outputs and measures of effectiveness.

- The Office of the Comptroller General and Treasury Board staff should coordinate their conduct of program evaluations and value-for-money audits on all ministries, Crown corporations and agencies.

- Financial resources within ministries should be strengthened by ensuring they all operate with a common accounting system and have appropriately trained personnel, more closely linked to the Office of the Comptroller General.

- Financial expenditure controls which are not centred on overall expenditure management functions, such as controls over full-time equivalent staff, should be eliminated.

- Appropriate management tools and targets should be established for revenue assessment and collection activities.

- The Lottery Fund should be brought within the central control framework.

- Asset management systems should be introduced which will manage the details of physical assets and maintain a database.

7. Financial Legislation

- The Financial Administration Act should be amended to emphasize the responsibility of Treasury Board in fiscal management and to place more responsibility on ministers and deputy ministers for the financial management and effectiveness of programs within their ministries.

- The Financial Administration Act and related legislation should be amended to provide more clear operating control over Crown agencies and other public bodies. Those amendments should emphasize policies and procedures for reporting on program performance, operating efficiency and effectiveness and actual outcomes, as well as budgetary and financial reporting activities.

- The Financial Administration Act should be amended to reinforce the focus on generation and collection of revenues within ministries and agencies of government. This could involve Treasury Board in ensuring that sufficient staffing is available to carry out income-producing activities as well as more specific responsibilities for ministries in achieving revenue objectives.

- The Financial Administration Act should be amended to provide for the carrying forward of an approved percentage of a ministry's appropriation from year to year to discourage hasty expenditures as the year-end approaches.

- The ease of access to special warrant provisions of the Legislative Assembly should be reduced by requiring stated reasons why a special warrant is urgently and immediately required.

- The Taxpayer Protection Act should be repealed and replaced with a plan which is closely tied to the fiscal management framework of the province by:

  - removing the requirement for overlapping five year plans.

  - recognizing that multi-year budgeting is a necessary part of the fiscal framework.

  - expanding the definition of debt and revenue to reduce the temptation to "window dress" results.

  - incorporation of the plan in the public accounts along with an appropriate progress report.

  - allowing the application of revenue as well as expenditure measures in achieving a balanced budget.

- The purpose and operation of the Privatization Benefits Fund should be evaluated and amendments introduced to accommodate a purpose and function in line with the new financial framework.

- The Budget Stabilization Fund Act should not be reintroduced. At the same time, a strategy should be developed for funding debt reduction without characterizing those payments as surplus.

8. Loans, Accounts Receivable and Guarantees

- The 1991/92 expenditures should include an additional provision of $316 million for loan losses.
- The carrying value of loans with generous repayment and low interest terms should be reduced to reflect the current financial value of the receivables.
- Accounts receivable collection policies should be improved so that accounts are collected on a more timely basis and fewer loan losses occur as a result of neglect or collection delay.
- Collection and payment policies should be amended to ensure appropriate priority for consumer taxes in the event of the financial failure of companies.
- Current loan remission programs, which are in effect retroactive grants to students, should be revised to eliminate the incentive to maximize borrowings. Companion revisions should be considered for other legislation that currently permits students to avoid repayment of student loans through bankruptcy.
- The practice of "ad hoc" business loans which are not within the guidelines of established programs should be stopped altogether. Instead, criteria should be developed and enforced for all economic development loan initiatives.
- The payout of loan guarantees has been poorly controlled and there are substantial hidden costs to treating grants as loans. The practice of using loans and loan guarantees when amounts are uncollectible should be stopped.

9. Government Services

- Clear responsibility should be assigned for the development and enforcement of a policy optimizing provincial space usage and reducing the proliferation of separate provincial offices in each community. Since the B.C. Building Corporation acts as a landlord, not a space manager, this responsibility should be dealt with by Treasury Board and its staff.
- Because B.C. Systems Corporation and the contractors working with it act as a service organization which responds to the needs of ministries, we recommend that a central organization set out the information system strategy of government and provide direction to ministries and to BCSC on how they will fit within it.
- The policy and standard setting activities for the purchase of government goods and services should be separated from the supply function currently carried out by the Purchasing Commission. The operating structure for the Commission should be evaluated and better delivery mechanisms considered.

- Steps should be taken to avoid the gradual emergence of a parallel and separate building management capacity consisting of individual agencies and growing ministry staff.

10. Forecasting and Fiscal Planning

- The multi-year forecasting process introduced this year should be expanded and incorporated into the fiscal framework mentioned above and into the budget process to encourage ministries to take a longer view on the results of their activities. Those long-view forecasts will take into consideration the category of "lurking expenditures" and significant trends impacting expenditure patterns. The budget development process should be amended to take a "zero-based" approach.

- The activities of the planning, economic analysis and Treasury Board staff should be expanded to ensure that appropriate resources are assembled to respond to a mandate of coordinating overall government policy and priorities within the budget and fiscal framework.

11. Lurking Expenditures

- Each ministry and government agency should be requested to identify the trends and events that could have significant impact on the budget of the province in the next three to five years.

- Ministries and agencies should be asked to develop strategies and options to avoid or mitigate all increasing costs inherent in those trends and events.

- A central planning agency within the Ministry of Finance and Corporate Relations should be given responsibility for accumulation of data on lurking expenditures, priorizing them and coordinating the development of a provincial response to avoid or mitigate their impact.

- Major lurking expenditures and new exposures should be anticipated by legislation limiting provincial liabilities.

12. Crown Agency Accountability

- There should be a central coordinating agency to ensure that Crown agency strategies and business plans support the government's public policy strategies.

- The central agency should have sufficient supervisory powers and resources to monitor the performance of the Crown corporations against approved performance standards.

- Crown agencies, as a direct reflection of their role to serve the public as part of an overall government strategy, should be appropriately accounted for in the Consolidated Revenue Fund so that the government's primary financial report on the stewardship of public monies is complete and accurate.

- A "zero-based" review of all Crown agencies should be performed to confirm their present role and placement in the current government environment of policy objectives and more effective resource management. This could result in a reduction in the number of separate Crown agencies.

- There is a need to define and classify Crown agencies according to appropriate criteria, and to account for them consistently against those criteria and to clarify reporting and disclosure requirements and several related audit and reporting issues.

13. Environmental Costs

- The Province must develop a centralized registry of contaminated sites to gain a clear review of any potential liability they entail and the cost of solutions that have to be developed.

- Develop procedures to increase emphasis on pollution prevention by:

  - increasing fines and penalties on owners;

  - establishing pollution prevention programs that act as an example;

  - reducing the number of "emergencies" that must be responded to.

- Provincial incentives to local governments should be more conscious of the conservation and purity of water supplies as well as the need for methods for improving sewage disposal.

- Develop legislation which would enable the redirection of use of Crown Lands without also incurring a liability for potential profits to those whose plans are altered because of the introduction of a new use or designation for the land involved.

- Consider the development of a series of environmental quality standards which can be used in the consideration of market-based and provincial initiatives designed to reduce environmental hazards.

14. Preventive Maintenance

- Implement new measurement methods and reporting formats to monitor the level of maintenance within ministries so that the magnitude and financial implications of deferred maintenance are readily apparent.

- Re-examine and redesign the budget management structure to eliminate incentives which encourage the allocation of funds for maintenance which are then diverted to ongoing operational purposes, necessitating subsequent capital programs to rebuild the infrastructure.

15. Personnel, Shadow FTEs and Collective Bargaining

- Eliminate the present focus on full-time equivalent employees and shift control onto actual expenditures for staff, regardless of category.

- Implement a personnel management system to monitor all categories of personnel—full-time equivalent, exempt full-time equivalent and those paid through manual payrolls and to encourage increasing productivity. The system should also be concerned with career development and training.

- Initiate a review of personal service contracting-out practices to determine its extent, cost, benefits and risks as compared with employing full-time staff, in consultation with the BCGEU.

- Develop a strategy through which the government will have a greater central influence over wage settlements agreed to by Crown corporations, health facilities, schools and other agencies, with the objective of ensuring that wage differentials reflect productivity differences rather than inconsistent compensation practices.

- Examine provincial staffing needs against actual mandates and approved service demands, and re-assign staff as indicated by this rebalancing.

- Provide additional staff, especially in the areas of importance to productivity improvement, revenue generation and expenditure control.

16. Resource Management

- Develop an integrated resource management strategy. Components of that strategy will entail:

    - inventorying resources such as ground water, surface water and forest resources.

- developing a long-term resource use/management policy that is adhered to over time.
- monitoring the quality and use of the provincial resources.
- developing appropriate royalty rates.
- carefully considering the implication of initiatives and legislation on the provincial resource base.

► Because of the current discussion of aboriginal land claim settlements, the implications of those claims should be reviewed for the purpose of understanding the implication of land claim arrangements on the resource base of the province and the additional complexity of managing the province's natural resources under a framework of overlapping jurisdictions.

17. Structure and Process of Financial and Policy Management

► Create a new central policy and planning group to support decision-making by Cabinet.

► Expand the strategic long-term focus of Treasury Board staff and give it a mandate to be more aggressive in taking action to achieve financial objectives.

► Coordinate the two perspectives, within a single policy framework.

VIII

A Final Word

In this report we have given a forecast of the deficit for fiscal 1991/92 and the likely deficit outlook, unless fundamental new directions are taken, for 1992/93 and 1993/94.

Having closely examined the government's financial circumstances, the forces shaping its future and its options for bringing the deficit down, we can reasonably be asked how **much** deficit reduction is possible over the longer term.

Of course, this will depend on decisions made by Cabinet and the Legislative Assembly. It is not our place to suggest policy goals for the Province. But we can comment on the extent of change we believe to be realistic, given the prevailing conditions.

The government will be facing a combined deficit for 1991/92 and 1992/93 that could be $4 to $5 billion or more. Balancing the budget will require a progression something like this:

- Reducing the deficit in 1992/93 below that for 1991/92; and in 1993/94 reducing it further.
- Balancing expenditures and revenues in 1994/95 or 1995/96.
- Running a **surplus** in 1995/96 and/or 1996/97 equivalent to the combined deficits of the first three years.

Can this be done?

In our opinion, the deficit for 1992/93 can be reduced below its level for 1991/92; and reduced even further in each successive year, barring a return of recession.

By how much? Not, we fear, by enough to fully balance expenditures and revenues over the period from 1991/92 to 1995/96 or to 1996/97. The deficit in the base year of 1991/92 is simply too large for that to happen. To bring the annual operating deficit down from $2.46 billion to zero within four to six years will be an extraordinary feat; but one that is achievable. It can be done by the right mix of careful spending cuts, better productivity, lower administrative costs, tighter revenue collection and selective revenue increases.

Also building a multi-billion surplus starting in 1995/96 would require both absorbing further expenditure cuts and immense additional revenue increases that are quite probably

beyond the province's capacity. But each passing year can bring **annual** revenue and expenditure closer together, and into structural equilibrium. If the economy cooperates, this can also produce the conditions for fully balanced budgets in four to six years.

Finally, the nature of this review was clearly financial. Consequently, our focus has been on financial matters. As a result there is an emphasis on a stronger financial framework within the Ministry of Finance and Corporate Relations. Because this review was charged with forecasting the deficit and committed to bringing forward recommendations for actions to mitigate against this in the future, it is inevitable that we concentrated on the identification of weaknesses in existing systems, mechanisms and processes. However, much that we found was excellent and deserves praise. Generally, we have been quite impressed with the competence and dedication of the public service in British Columbia. We are certain they will be able to carry out their part in reducing the deficit and making the government work more effectively.

Appendix A

Forecast of Revenue and Expenditure for the Year Ending March 31, 1992

A. Forecasting methodology

Each month the Ministry of Finance and Corporate Relations prepares a monthly budget scorecard which is part of the internal monthly financial and economic report prepared by the Ministry. The December budget scorecard, which has been the starting point for these forecasts, was prepared with reference to the actual expenditure results provided by the Office of the Comptroller General and contact with both ministry financial officers and members of Treasury Board staff responsible for that area of expenditure. The Treasury Board staff, in addition to maintaining a familiarity with activities within ministries and government agencies, also maintain a record of approved deviations from budgets as established. This process and the investigation of specific issues raised by us during our review of government entities, have resulted in the forecast in this report. We have worked closely with the Ministry staff, reviewing the information in the scorecard, investigating specific issues raised by our review of loan values, ministries and crown agencies and analyzing the results. The forecast which forms part of this report is the result of this process.

B. Accounting policies

The 1991 accounts are a fundamental reference point for the forecast. The 1991 Consolidated Revenue Fund Accounts were published as part of the Public Accounts by the Minister of Finance and Corporate Relations on November 29, 1991. Attached to the statements is the report of the Auditor General, Mr. George L. Morfitt, F.C.A., provided his report on the statements dated August 15, 1991. In his report, he points out that the accounts do not record the government's liability for the unfunded portion of pension benefits earned by employees. The following paragraph of his report sets out this deficiency:

> *"These financial statements do not include the government's liability for the unfunded portion of pension benefits earned by employees. The government only records, as pension expenditure, the amount of funding it provides in accordance with the Pension (Public Service) Act. If the government had been recording the full cost of pension benefits accrued to its employees in each fiscal year, in the manner recommended in 1988 by the Canadian Institute of Chartered Accountants, the government's*

liabilities and net deficiency would have been increased by approximately $441 million as at March 31, 1990, the date of the latest actuarial valuation pursuant to the Pension (Public Service) Act. Since no other actuarial evaluations have been carried out using the recommended actuarial benefit method, the effects on the consolidated net revenue (expenditure) for the years ended March 31, 1990 and 1991 and on liabilities and net deficiency at March 31, 1991, are not reasonably determinable."

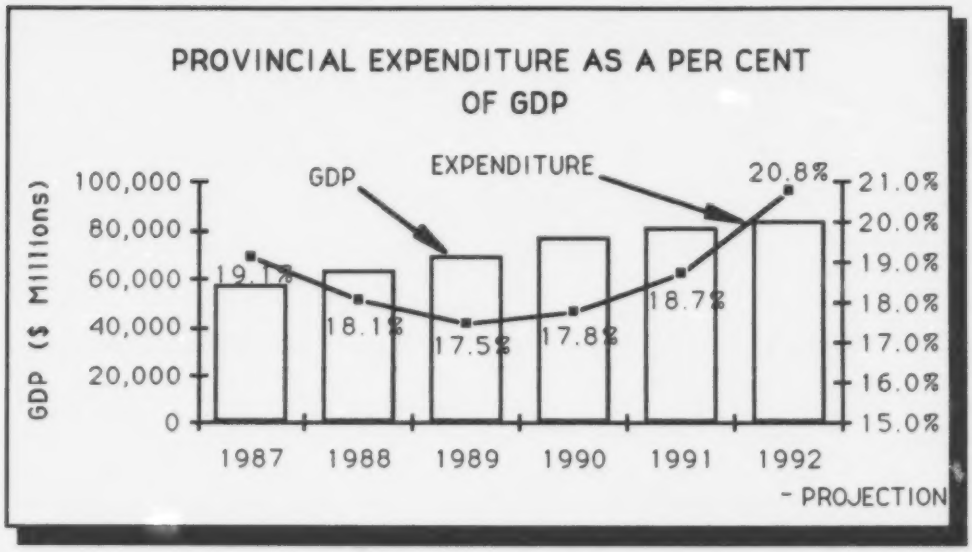
In his report issued January 24, 1992, the Auditor General again referred to the deficiencies in the accounting policies of the province and pointed out the general standards of financial statement presentation with which the province does not comply. A discussion of the deficiencies in the accounting policies is provided in Appendix B.

To preserve the comparability of the forecast to the published results for 1991 the forecast has been prepared using the same accounting policies as those used in the 1991 accounts. Revision of the accounting policies would produce different results, the impacts of which are set out in the body of the report.

C. Overview

The Province of British Columbia has a reputation for good fiscal controls. Even the forecast results for the year ending March 31, 1992, track budget approvals closely when they are adjusted for the easily identified impact of the economic downturn and specific expenditure decisions. While these controls have remained in place and operated with a reasonable degree of effectiveness, the pattern of expenditure has been moving upward at a sharp angle throughout 1990/91 and increases are forecast to continue into 1991/92.

The following graph illustrates total provincial government expenditures as a percentage of the provincial Gross Domestic Product. The Gross Domestic Product of the province is an indicator of the goods and services produced. As can be seen from the graph, the percentage attributable to provincial expenditure has grown from some 15.9 per cent to 19.6 per cent in 1989 as we approach the end of this fiscal year.[1]



At the same time as expenditures were growing as a percentage of Gross Domestic Product, total revenues were decreasing. Part of that reduction can be attributed to the economic downturn and the reduction in funding from the federal government which is now some $1.14 billion less than what might otherwise have been expected for the 1991/92 year.

D. Revenue

While revenue has increased steadily during the past five years, the rate of increase has slowed recently. This is due to a combination of factors including a move by the federal government to freeze cost-shared payments to the provinces and no introduction of new revenue measures. Growth in revenue has been further impaired by weak economic conditions.

The following chart illustrates the trend in the various components of British Columbia's revenue during the past five years and the forecast for 1991/92.

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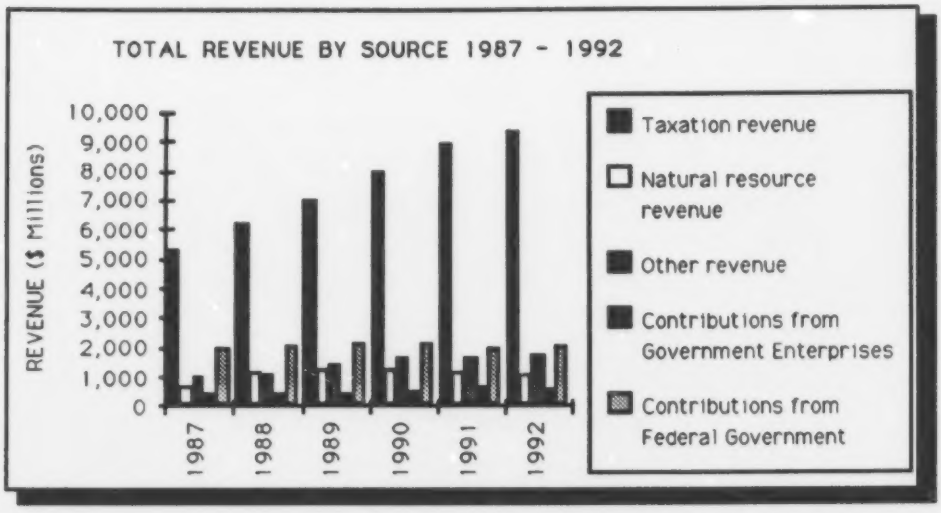
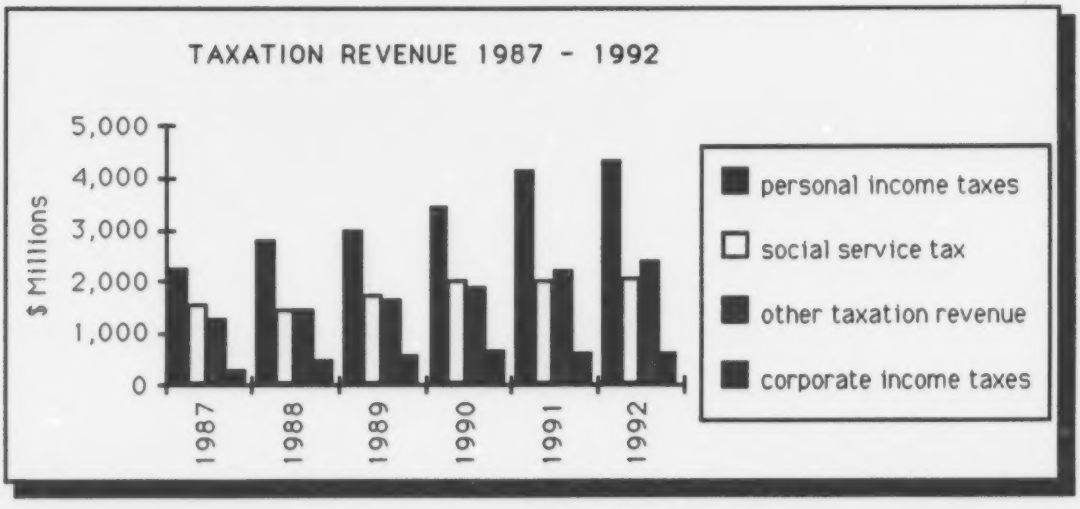
1 *The information used to prepare this graph was provided by Treasury Board staff. Expenditures have been adjusted for changes in accounting policies that have occurred over the period.*



As revenue has grown, the importance of the different sources of revenue has changed, with personal income taxes leading in the rate of growth. The following graph illustrates the increasing relative importance of personal income taxes and other provincial taxes as a source of revenue over recent years.



The following schedule sets out the actual revenue from taxation in 1990/91 and amounts forecast for 1991/92:

	($ Millions) Forecast 1991/92	Actual 1990/91	% Change
Personal income taxes	$4,300	$4,140	3.9
Corporate income taxes	615	608	1.2
Social services tax	1,980	2,010	(1.5)
Other taxes	2,394	2,198	8.9
Total	$9,289	$8,956	3.7

Personal income taxes — $4,300 million

- Personal income taxes are the largest single source of revenue to the province, accounting for 28.8 per cent of the total revenue. The amount of personal income taxes payable by a British Columbia resident is a percentage of the federal income tax. The current rate is 51.5 per cent of the basic federal tax, increased by a 10 per cent surcharge on high income earners in the years 1991 through 1994.

- The federal government acts as the provincial agent in the collection of these taxes. It provides estimates of basic federal tax which are adjusted by the Ministry of Finance and Corporate Relations to reflect the province's estimates of current economic variables. The most recent review estimates growth in personal income tax revenue of 3.9 per cent in 1991/92 over amounts collected in 1990/91.

Corporate income taxes — $615 million

- Corporate income taxes are a relatively small component of the total provincial revenue (4 per cent). Corporations are taxed on income earned through their business activities in British Columbia. The current rate is 9 per cent for corporations qualifying as small businesses and 15 per cent for those not so qualifying.

- The federal government acts as agent for the collection of corporate income taxes and prepares a periodic estimate of corporate income taxes to be collected in Canada. In November 1991, the federal government lowered its estimate for corporate income tax receipts by $8.1 billion to $36.6 billion, reflecting a significant deterioration in the profits forecast by Canadian corporations. Corporate income taxes are difficult to

predict because corporate incomes vary more sharply with economic activity. The forecast revenue reflects the reduced expectation in corporate profitability for 1992.

Social service tax — $1,980 million

- Social service tax is the second largest component of the province's total revenue at 13.3 per cent. The general tax rate on purchases of tangible personal property imposed under the social service tax is 6 per cent. Liquor products are taxed at a rate of 10 per cent.

- Due to weak retail sales and corporate spending, social service tax is expected to decline marginally over the 1990/91 level. The decline is estimated at 1.5 per cent.

Other taxes — $2,394 million

- The following schedule sets out the actual revenue from other forms of taxation in 1991 and amounts forecast for 1992:

	($ Millions) Forecast 1991/92	Actual 1990/91	% Change
Fuel	$ 542	$ 555	(2.3)
Tobacco	435	347	25.4
Property	926	908	2.0
Property purchase	295	211	39.8
Other	196	177	10.7
Total	$2,394	$2,198	8.9

- Property purchase tax increased during 1991/92 with the improvement in the real estate market. Tobacco tax revenue increased significantly due to increased tax rates on cigarettes. The effect of the tax increase has been somewhat offset by declining consumption resulting from a more health-conscious population, increased cross-border shopping and smuggling. A rural property tax freeze was implemented in 1991 and is assumed to continue through 1994.

Natural resource revenue **$1,105 million**

- The following schedule sets out the actual revenue from natural resources in 1991 and amounts forecast for 1992.

	($ Millions) Forecast 1991/92	Actual 1990/91	% Change
Petroleum and natural gas	$206	$280	(26.4)
Minerals	33	45	(26.7)
Forests	598	609	(1.8)
Water and other	268	237	13.1
Total	$1,105	$1,171	(5.6)

- Petroleum and natural gas revenues are derived from bonus bids and royalties and vary with the price of oil and natural gas. Forests are the largest component of natural resource revenues. Over 90 per cent of forest revenue is in the form of stumpage. Following a change in the stumpage calculation, revenue from forests is now quite insensitive to economic conditions.

- Water rentals revenue is forecast to increase during 1991/92 due to an increase in volume and a 15 per cent water rental rate increase introduced on January 1, 1992. A further rate increase of 2.4 per cent is expected on January 1, 1993.

- Historically, natural resource revenue has been quite volatile. Revenue from natural resources varies with British Columbia's GDP as resources form a significant component of this economic indicator.

Other revenue — $1,803 million

- The following schedule itemizes the actual revenue from other sources in 1991 and amounts forecast for 1992.

	($ Millions) Forecast 1991/92	Actual 1990/91	% Change
Medical Service Plan premiums	$740	$661	12.0
Lottery Fund	203	205	(1.0)
Other fees and licences	525	449	16.9
Investment earnings	145	140	3.6
Miscellaneous	190	234	(18.8)
Total	$1,803	$1,689	6.7

- In general, revenue from other sources tends to be quite stable. Significant changes can occur in Medical Service Plan premiums due to increases in premium rates and population growth. Revenue from lotteries has levelled off and is not anticipated to increase substantially in the future. Investment income depends on the level of cash balances and the investment performance of the treasury.

- Other revenue also includes funds derived from motor vehicle licences and permits, other fees and licences, fines and penalties and miscellaneous other sources.

- The 1991/92 estimate of other revenue has increased 6.7 per cent over its 1990/91 level in response to population growth and increases in rates.

Contributions from government enterprises — $531 million

- The provincial government receives dividends or transfers from the Liquor Distribution Branch, B.C. Hydro and other government enterprises. Total revenue from this source accounts for 3.6 per cent of estimated 1991/92 revenue. Dividends received from the Liquor Distribution Branch tend to be quite stable. Dividends received from B.C. Hydro are reduced in the current year because of the program to bring maintenance up to a more acceptable standard.

- Dividends from the Liquor Distribution Branch are expected to increase one per cent over the 1990/91 level, reflecting increases in volume combined with the change in consumption from high margin liquor to lower margin wine, beer and coolers.

- The forecast of B.C. Hydro and Power Authority dividends is $50 million for 1991/92.

Contributions from the federal government **$2,064 million**

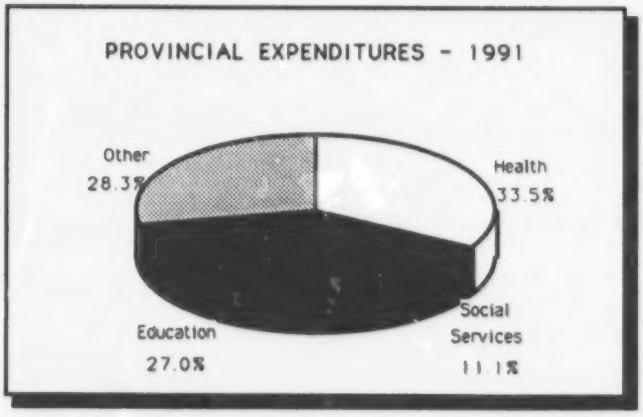
- Approximately 14 per cent of provincial revenue is derived from contributions from the federal government, of which approximately 90 per cent is received from Established Programs Financing and the Canada Assistance Plan. The remaining 10 per cent is received from over 70 other programs. It is estimated that the federal government's gradual reduction in all previously cost-shared programs, both major and minor, has resulted in lost revenue for the province for fiscal 1991/92 of $1,173 million.

- The federal government's move to off-load funding has created future uncertainty as revenue sources are adjusted and/or programs are unilaterally reduced.

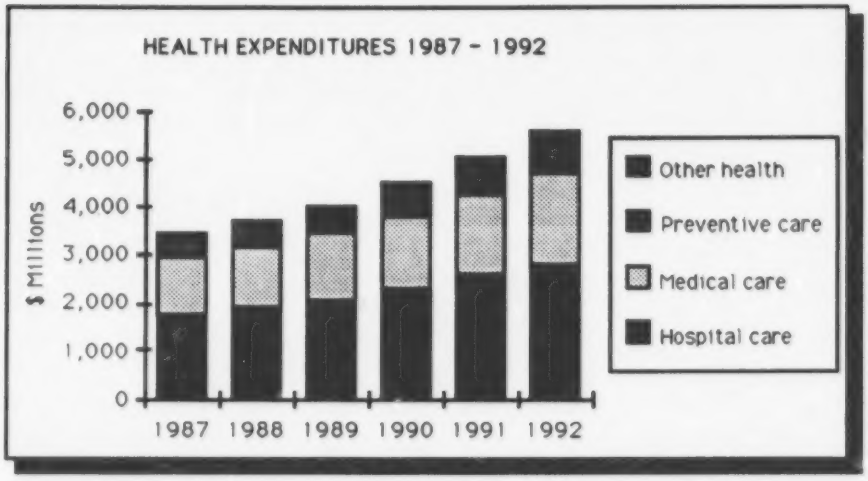
- The current estimate is that the 1991/92 contribution from the federal government will be 5.2 per cent greater than the 1990/91 revenue received.

E. Expenditures

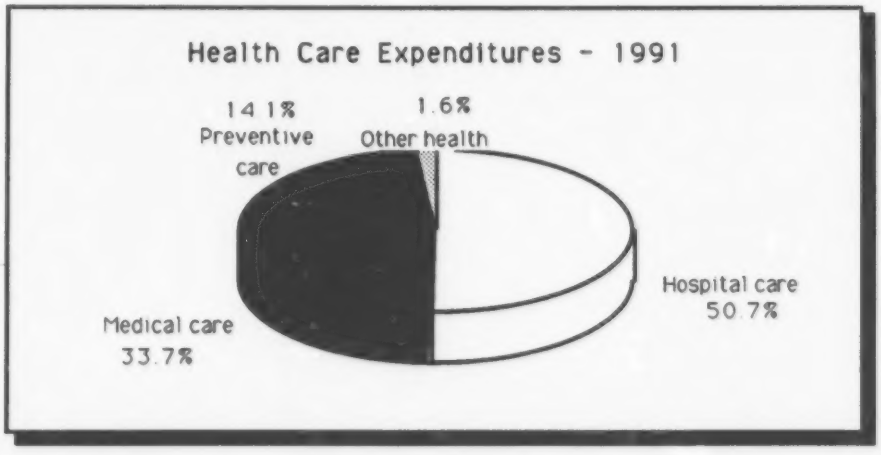
The chart below illustrates the significance of health, education and social services in the provincial expenditure patterns.



- Set out below is a graph that illustrates the trend in provincial government health expenditures and the relative composition of those expenditures.



- The following chart illustrates the composition of health care expenditures during fiscal 1990/91:



- Funding for the Hospital Care Division is based on population information adjusted for demographic and referral patterns. Hospital care costs include operational costs, construction and renovation costs and equipment purchases. Medical care costs under the Medical Service

Plan include payments to physicians and surgeons, payments to supplementary benefit practitioners and costs of administration. Preventive care encompasses programs of public health inspection, facilities licensing, health services for schools, etc. It also includes the British Columbia Centre for Disease Control. Other health services include continuing care programs, ambulance services and miscellaneous other services.

- Expenditures for health care are primarily driven by wages. For every dollar of expenditure in the Ministry of Health, 80 cents goes ultimately to wages, salaries, physicians' fees and benefits. For health sector wages, fees and benefits in general, each percentage point costs approximately $43 million.

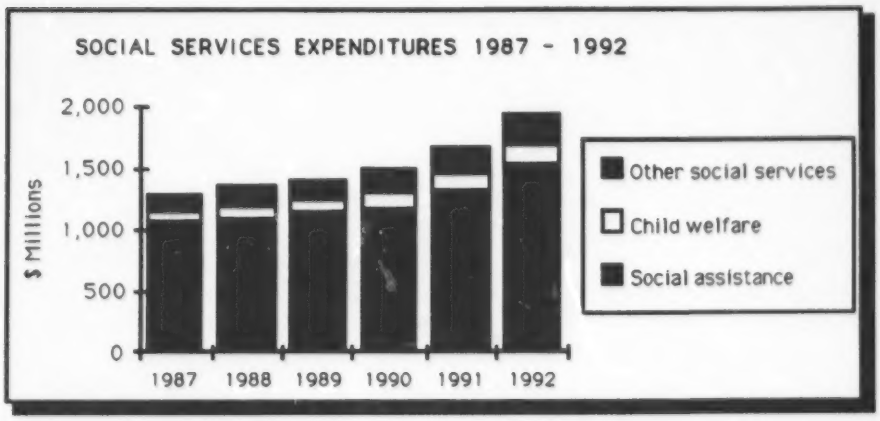
- On average, the per annum cost of a hospital bed is $114,000 in British Columbia. The average per diem rate per hospital day is $570. Growth in the British Columbia population contributes to increasing pressure on health care expenditures. In the next 18 years, provincial growth is estimated at 35%. In addition, over the same period of time, the growth in the population will include a 66 per cent growth of individuals over 65 years of age. Nearly 50 cents of every health care dollar is spent on providing care to this group, which currently comprises a mere 16 per cent of the population.

- In addition to the demographic pressures on health expenditures is the growth in programs. Many programs and services in the health sector exist within an open-ended system. As a result, the growth in program and service activities has been significant in a number of areas.

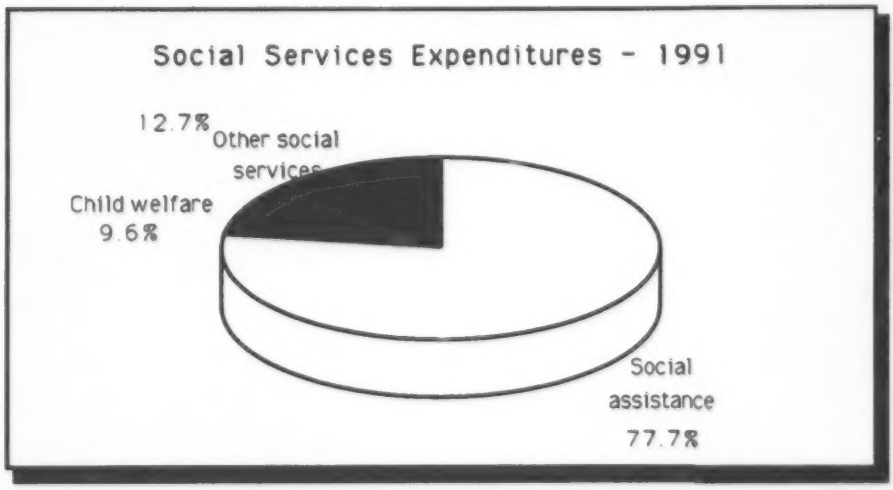
- The forecast for health care expenditures for 1991/92 includes a 25 per cent increase for pharmacare to cover higher drug costs and increases in utilization, a 16 per cent increase in emergency health services to cover higher wages and increased ambulance utilization, a 15 per cent increase in the cost of continuing care to cover higher wages and benefits and a 19 per cent increase in medical services to cover increased utilization and wages and benefits.

Social services $1,974 million

The trend of provincial expenditures incurred in the area of social services is set out below as well as the composition of the expenditures.



The following chart illustrates the composition of social services expenditures during fiscal 1990/91:



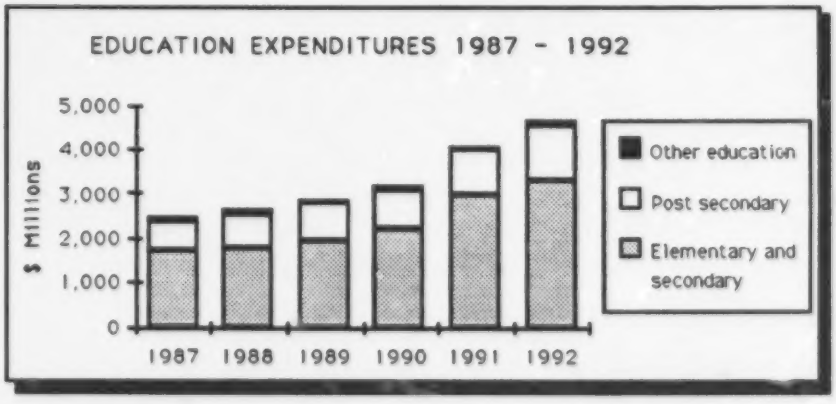
- Social service expenditures assist British Columbians in need and help them regain self-sufficiency. Programs for independence are mandated by the Guaranteed Available Income for Need Act (GAIN). Social

service also provides assistance for persons with handicaps, family and children's services, community support services and services for seniors. Approximately 61 per cent of the expenditures made by the Ministry of Social Services goes to income assistance and related program costs. Therefore, the projection of total social service expenditures is closely related to the forecast of British Columbia's level of unemployment. Population growth in British Columbia puts further pressure on the costs of providing social services.

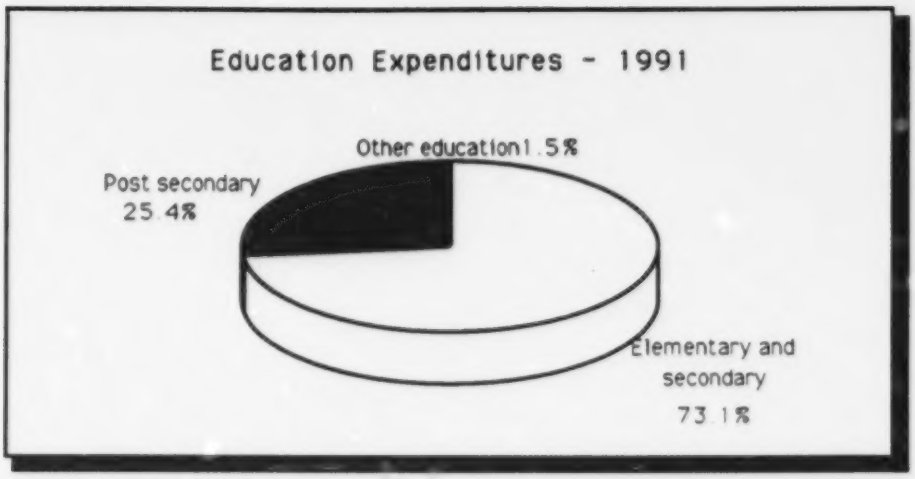
- The cost of social services is expected to increase 17.9 per cent in 1991/92 from 1990/91. The current forecast for the expenditure on social services reflects the increased demands on social programs during 1991/92. The current weak economy and changes to federal unemployment insurance eligibility rules are moving people more rapidly to income assistance. In addition to the effects of the economic situation, spending during the current year reflects increased resources for administration and support services, the cost of running dual programs for the mentally handicapped as they are moved from institutions into the community, and increased funding for day-care programs.

Education **$4,579 million**

- Set out below is the trend of expenditures in education and the composition of the expenditures.



The following chart shows the distribution of education expenditures:



- The cost of elementary and secondary education is driven by teachers' salaries, associated benefits and population growth. Approximately 85 per cent of the public school funds is spent on salaries. Expenditures on elementary and secondary education will increase in the future to cover debt servicing costs associated with "catch-up" programs in school maintenance and building expenditures. The year over year increase in debt service costs is projected at 13 per cent in 1992/93 and 21 per cent in 1993/94. Post secondary education expenditures also vary with the cost of faculties' salaries and benefits. As with schools, 85 per cent of the cost of post-secondary education goes to salaries. Pressure on the cost of post secondary education has been recently impacted by the "Access for All" initiative as both the number of students in the post secondary age group and the participation rate increase.

- The 1991/92 forecast for education is a thirteen per cent increase over the 1990/91 expenditures reflecting population growth and rising operating expenses. In response to the Royal Commission on Education, the province introduced "block funding" in 1990/91 for public schools. Each year, the government establishes an average per student amount, which is multiplied by the total projected enrollment to establish the block of funds for public education. The block is adjusted each year to reflect economic and enrollment changes. The base amount in 1991/92 was $5,500 for each of the 527,000 students in the system. The 1990/91 base amount was $5,259.

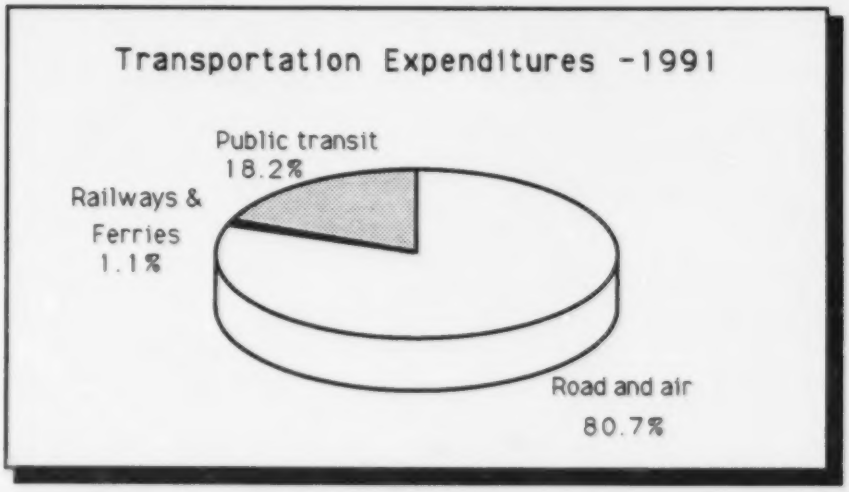
Provincial funding for the three universities, 19 community colleges and institutes and two agencies covers approximately 75 per cent of their operating expenses. The cost of support for post-secondary education is expected to increase in 1991/92 to cover increased salaries and a 16 per cent increase in debt service costs.

Protection of persons and property **$854 million**

- Expenditures for protection of persons and property are forecast to increase 17.8 per cent in 1991/92 over 1990/91. Expenditures in this category are made for law enforcement, police protection, corrections and other protection and regulation. Much of the expected increase in expenditures during 1991/92 is a result of large payments for flood relief, increased expenditures for criminal injury compensation and the Legal Services Society.

Transportation **$1,269 million**

- Transportation costs include the costs associated with road and air travel, ferries, railways and public transit. The following pie chart shows the distribution of expenditures for fiscal 1990/91.



- A large portion of transportation expenditures are discretionary in that they relate to new construction and rehabilitation of existing roadwork systems. The ongoing commitments relate to maintenance and funding assistance to transit. As a result of the "Freedom to Move" plan, the public's level of expectations for new or improved transportation

facilities have been raised considerably. Initial estimates of projects aggregated some $12 billion over the next ten years, of which highways alone would account for $9.3 billion.

- Announced programs include the extension of SkyTrain, construction of the Island Highway and expansion to ferry terminals which will cost $3.5 billion over the next five years.

- The 1991/92 transportation cost increase reflects the increased operating contribution to B.C. Transit and funding for highway rehabilitation relating to approved projects.

Natural resource and economic development **$1,538 million**

- The following schedule sets out the major components of actual natural resource expenditures for 1990/91 and the forecast of expenditures for 1991/92:

	($ Millions)		
	Forecast 1991/92	Actual 1990/91	% Change
Forests	$ 730	$ 574	27.2
Trade and industry	379	159	138.3
Environment and agriculture	349	287	21.6
Minerals and mines	80	43	86.0
Total	$ 1,538	$ 1,063	44.5

- The largest increase in natural resource and economic development expenditures in 1991/92 is in Economic Development which reflects a $208 million provision for loan losses. Significant increases are also forecast in Forests, partly due to the South Moresby Island settlement, and in Agriculture, Fisheries and Food due to a payment to the tree fruit farmers.

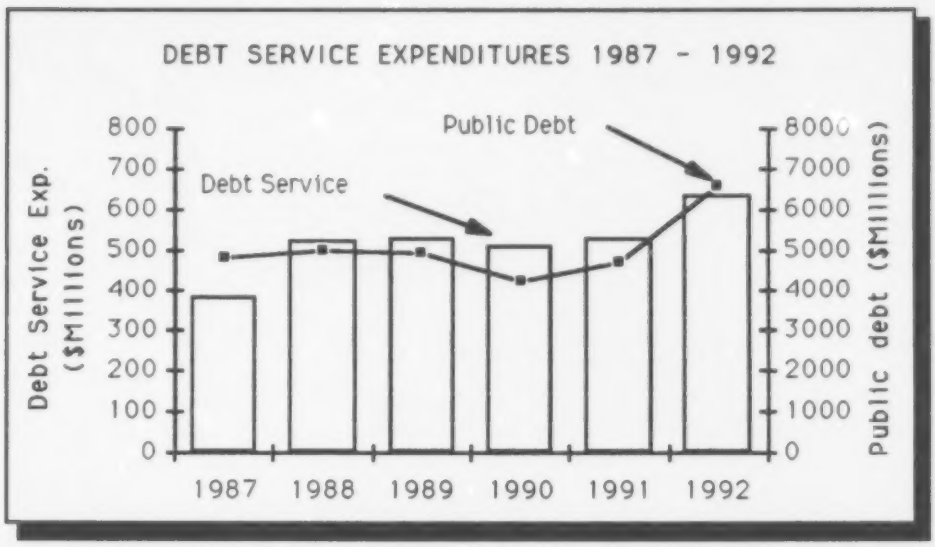
Other **$560 million**

- Other government expenditures include costs associated with municipal affairs, recreation, housing and lottery fund grants. The 1991/92 forecast expenditure for this category is 10.6 per cent higher than that in 1990/91.

General government **$287 million**

- General government expenditures include the costs associated with running the legislature and providing the general administration of the government. General government expenditures are forecast to increase 18.6 per cent over 1990/91. The increase is partially due to the purchase of government vehicles and the provincial election held during 1991.

Debt service costs **$635 million**



- Debt service costs include interest payments made to third parties. Debt service costs depend largely on the general level of interest rates, the province's credit rating as evaluated by the rating agencies, the borrowing requirements of the province and the level of provincial debt outstanding.

- Although debt servicing costs are reduced by lower interest rates, that saving is offset by a 37 per cent increase in the outstanding debt to result in an overall increase in debt service costs in 1991/92

- Debt has increased because of the deficit and the loans to school districts and hospitals for capital construction.

Appendix B

Recommended Accounting Policy Changes

A. Background

The accounting policies of an organization are the criteria it adopts for the recording of transactions and recognition of assets and liabilities. Consistent recording of such costs as income assistance payments, wage payments and liabilities allows the financial statements which summarize those transactions to be comparable from one year to the next, as well as to other organizations of a similar nature.

Accounting policies applied to commercial enterprises recognize that for many businesses, equity ownership is segregated from management and debt investment is required to accumulate sufficient capital to start the business and acquire assets. Accordingly, investors and creditors are particularly interested in the financial statements of commercial enterprises so that they can make credit decisions and predict the ability of the entity to earn income and generate cash flows. The interests of investors and equity shareholders dominate the approach to accounting policies employed in commercial enterprises. As a result, the accounting policies and practices are well developed in matching expenses against income earned and reflecting assets and liabilities on the balance sheet. For example, the profit earned in one hotel or retail store can generally be compared to the profit of another knowing that the accounting policies employed are quite consistent.

Governments however, are different from commercial enterprises, both in their objectives and methods of financing. Indeed, governments vary one from another in the goals they are pursuing and how the funding is achieved. Broadly speaking, a government organization delivers a service which does not give rise to revenue; such services are funded through taxes or levies on a defined group of contributors.

For instance, the members of a community may agree to acquire fire protection equipment and fund a fire department through a tax levy against their properties. Of particular interest is whether revenues and expenditures agree with those budgeted and if sufficient funds are being collected to meet expenditures including acquisitions of equipment and supplies. The financial statements are prepared to answer the question "Did we raise enough money to pay our bills?"

The failure of many public bodies during the great depression of the 1930s reinforced this focus on matching current revenue against expenditures regardless of their nature.

Whether the fire department was acquiring a new truck or repairing an old one, the accounting policies focused on the need to match expenditures against available revenue. Accounting policies and related financial statements that focus attention on current revenue and the expenditures made from it encourage the organization to be prudent in fiscal planning and avoid over-extending itself through debt commitments. On the other hand, it means that the organization does not record the accumulation of assets, nor does it attempt to match in an organized way, the useful life of assets acquired against the taxing periods which will benefit from the use of these assets.

The accounts of the Province of British Columbia currently contain no non-financial assets. The roads, buildings and equipment used by the government are treated as expenditures and matched against revenue as they are acquired. As a result, the balance sheet shows only cash, investments and financial receivables as assets while recording accounts payable and all debt obligations as liabilities.

This has the advantage of providing information on the resources acquired during any fiscal period from the revenues raised. However, it also means that the repayment of debt to acquire assets which will benefit future periods must be repaid by operating at a surplus, leaving the impression that there is money to spare even if it is committed to debt repayment.

A discussion of the objectives and accounting policies for governments has developed over the last decade. It has been brought on by an increasing concern about the liabilities and obligations of governments not disclosed on their balance sheets and the fact that governments have moved increasingly into the operation of quasi-commercial enterprises like B.C. Ferry Corporation, the Insurance Corporation of British Columbia and many other enterprises where a matching of revenues and expenditures to measure profitability rather than just the use of funds is more appropriate. Responding to the debate, the Canadian Institute of Chartered Accountants established the Public Sector Accounting and Auditing Committee (PSAAC) in 1981 with the following mandate:

> *"To consider matters of public sector accounting and auditing theory and practice and to render on its own authority, such pronouncements as it considers in the best interest of the community as a whole, and*
>
> *To provide for the growth of Canadian accounting and auditing literature for the public sector by encouraging specialized studies."*

PSAAC has worked in cooperation with government and other public body financial officers and auditors to develop standards for disclosure of accounting policies, preparation of financial statements and a variety of other matters relating to how the accounts of a government are presented. As one might expect, pronouncements in one area lead to the need for pronouncements in another where matters inter-relate. Accordingly, the majority of the material published by PSAAC has been released since 1988. Because of the diverse nature of the activities of each province and public body, adoption of accounting policy recommendations is not straightforward and often requires the development of a new accounting policy for related areas of the organization so that a

reasonable representation of the affairs of the province can be reflected in the accounts. These problems have led to varying levels of adoption of accounting policy recommendations in one province compared to another.

The approach adopted by PSAAC, once it defined the overall objectives for government financial statements, has been to address specific accounting and reporting concerns. This has led senior governments to adopt new policies as PSAAC develops them or run the risk of their auditors expressing reservations on the government financial statements.

The province has made a concerted effort to be at the forefront of adoption of evolving accounting principles for governments but, because of the accelerating rate of change and complexity in developing certain accounting policies, it has not always succeeded in keeping pace with the latest changes. An example is the policy related to unfunded pension liabilities on which the Auditor General issued a reservation qualifying his opinion on the fairness of presentation of the government's financial statements for the 1990/91 fiscal year.

Indeed, a number of provincial governments and the federal government have reservations expressed by their auditors on the government accounts because of their inability to keep up with current changes to accounting policies and disclosure standards.

In his latest report, Mr. George Morfitt, F.C.A., the Auditor General, identified 10 recommendations of PSAAC which the province is not currently adopting. We have proposed a number of accounting policy changes which, if accepted, will ensure that the majority of Mr. Morfitt's concerns are fully addressed and provide a reporting structure which will make the full extent of government activity more visible and provide greater accountability to the public. We believe that the government should accept and implement the majority of these recommendations for its 1991/92 reporting year; the balance, although important, require further study and should be considered for subsequent implementation.

B. Accounting policies with which the Province of British Columbia is not now complying

1. Accounting for employee pension obligations

It has been the practice of the Province of British Columbia to record as expenditures contributions to the Public Service Superannuation Fund to meet the future retirement costs of employees . The province has not recorded as a liability the shortfall in the balance of the fund from that required to meet all the pension obligations already incurred as estimated by actuaries. At March 31, 1990, actuaries computed the unfunded liability to be approximately $441 million. Smaller unfunded liabilities exist in other funds. PSAAC Public Sector Accounting Statement #5 which deals with pension obligations recommends the recording of these deficiencies as liabilities and to record pension expenses equal to the value of

pension benefits earned by employees during the year, rather than simply expensing cash contributions to pension plans. Some governments already adopt this approach, and, as a result of report qualifications by their auditors, other governments are considering the adoption of this approach.

We recommend that the province amend its accounting policy to comply with the PSAAC recommendations with the result that unfunded pension liabilities of approximately $558 million would be shown on the balance sheet at March 31, 1992 and pension expense in the 1992 year would increase by approximately $71 million. The balance of the pension liability would increase the accumulated deficit of prior years.

2. Accounting for government transfers

Approximately 75 per cent of provincial government expenditures are made by way of transfers to other agencies or individuals. Those transfers or grants are now recorded as expenditures when the funds are disbursed.

Public Sector Accounting Statement 7 released by PSAAC has recommended that transfers and grants be recorded as expenditures when the payment is authorized provided the recipient has met the eligibility criteria. In general, this will mean recording such grants and transfers as expenditures earlier than is now the case within the Province of British Columbia. It will also mean that grant and transfer obligations undertaken by the province will be shown as liabilities on the balance sheet.

Adopting this accounting policy will likely result in recognizing an obligation at the end of March 1992 of approximately $70 million and have the potential effect of increasing the deficit for the 1992 year by $5 million.

3. Contingent liabilities and commitments

At any point in time, the Province of British Columbia is the defendant in various legal actions claiming damages resulting from the failure of government officials to perform required duties, construction disputes, tax assessments and a wide range of other issues. At March 31, 1991, the notes to the financial statements disclosed claims aggregating some $500 million. The notes also disclose the existence of other contingent liabilities relating to hazardous materials, indemnities, guarantees and other outstanding claims.

The current policy of the province is not to record any of those amounts as expenditures because the outcome of the litigation is uncertain or the amount of the claim or indemnity is uncertain. This approach to recording of expenditures fits traditional recording practices in government but is not in keeping with current PSAAC recommendations or the standard for recording transactions set out in the Canadian Institute of Chartered Accountants Handbook for commercial enterprises.

The Auditor General for the province has suggested an expanded recording of liabilities of a contingent nature which would be more in keeping with current accounting standards. His approach would expand the definition of accounts payable and accrued liabilities to include:

> *"Liabilities of a contingent nature where there is a clear, legal obligation to incur expenditures relating to events or transactions occurring at or prior to the date of the financial statements, and the amount of the obligation can be reasonably estimated."*

We believe this revision to the definition of liabilities would bring accounting policies of the province more appropriately in-line with current standards. Its adoption would result in the inclusion of additional liabilities at the end of March 1992 of approximately $124 million. Expenditures and the deficit for 1991/92 would both increase by $41 million, with the balance of $83 million increasing the accumulated deficit of prior years.

4. Concessionary loans

A number of provincial government assistance programs involve the use of loans or advances where the repayment terms and interest rate are significantly below market or normal terms. As long as the beneficiary continues to comply with the terms under which the funds were advanced, they are treated by the Province of British Columbia as an asset and the lower than commercial terms not reflected as an expenditure in the accounts.

We propose that new accounting policies be adopted to take into account the different concessionary nature of some loans. When the terms of a loan are so concessionary that the substance of the transaction is in the nature of a grant, it should be accounted for as a grant. When the rate of interest charged by the Province is different from a commercial lending rate, only the present value of the amount expected to be repaid should be recorded as assets.

Adoption of this accounting policy would entail reducing the carrying value of concessionary loans so that they reflect an asset of normal commercial value and treating the difference, which equates to the concessionary nature of the loan, as an expenditure. This accounting policy would result in reducing the value of loans at the end of March 1992 by approximately $130 million and increasing the deficit for 1992 by $21 million through an increase in expenditures. The balance, $109 million would increase the accumulated deficit of prior years.

5. The cumulative effect of these changes

It is relatively unusual for governments to restate the accounts for prior years. In most cases we believe that such retroactive restatement should not be used, especially where controversial government transactions are concerned. However, with these policy changes, the recommendations are fundamental to the definition of liabilities and financial assets. As a result, for comparability purposes, we are of the view that the government should adopt these new policies and apply them retroactively to its financial statements. The Province has followed this method before, with similar significant policy changes. If the government adopts these policies for the 1991/92 year, the effect on the current year's deficit and accumulated deficiency would be as follows:

	Overstated Assets at March 31/92	Unrecorded Liabilities at March 31/92	Effect on 1991/92 Deficit
		($ Millions)	
Unfunded pensions	$	$ 558	$ 71
Unrecorded grants		70	5
Contingent liabilities and commitments		124	41
Concessionary loans	130		21
	$ 130	$ 752	$ 138

C. Interconnected accounting policy changes for consideration

In addition to the above accounting policy changes, we have identified three additional areas which merit serious consideration by the government. We have recognized that a great deal of work will need to be undertaken before these are implemented and, accordingly, we have not included them in the changes which we recommend for immediate implementation. These additional areas are inter-connected and the proposed changes, if adopted, will establish the province at the forefront of government accounting policies.

1. The appropriate government reporting entity

As mentioned, the Province of British Columbia prepares three main sets of accounts:

- the General Fund
- the Consolidated Revenue Fund
- the Summary Financial Statements

Each is different in that the accounts of different funds, Crown agencies and Crown corporations are included. This diversity of accounts is confusing to the knowledgeable reader, let alone the general public of British Columbia, and makes it difficult to develop a clear picture of the financial activities controlled by the provincial government.

We believe the accounts of the Province of British Columbia should consolidate, in one main set of accounts, the activities of all the Crown corporations and agencies for which it is responsible. This consolidated financial statement would be a more appropriate government reporting entity and ensure that in the one main set of accounts, those corporations and agencies which reflect provincial government policy and carry on its business affairs are reported as part of the provincial entity. Similar revision would be required to the preparation of the government Estimates so that they too incorporate the Crown corporations and agencies and are on a comparative basis with the primary published financial statements.

In addition, we believe the government reporting entity should include the activities of all organizations which it owns or controls and which are effectively accountable to a minister for their financial resources. The way in which these activities are incorporated requires further study to ensure that the published reports of the province still become available on a timely basis. These organizations would include schools, hospitals, universities and colleges.

2. Fiscal agency loans

A fiscal agency loan occurs when the Province of British Columbia takes advantage of its greater borrowing expertise and credit rating to borrow monies for a Crown corporation or agency with which it has a close working arrangement. For instance, $3.7 billion has been borrowed by the province and made available to British Columbia Hydro and Power Authority. British Columbia Hydro and Power Authority will in turn repay those loans through revenue earned in the sale of electrical energy. In some situations however, like funding of building construction for school districts and hospitals, the source of ultimate repayment will be the grants or transfers from the province. It is these loans where repayment will come from the grants or transfers that have been the subject of discussion.

The Auditor General has recently stated that amounts receivable by the government from public bodies should not be considered as assets. It is argued that these advances to agencies, which will repay the funds from government grants, are simply advance grant payments and should be treated as expenditures on the government accounts rather than as loans. On the other hand, the expenditure creates additions to the physical plant of the province not now on the balance sheet.

Since these loans are not considered financial assets, we believe these loans should be considered for removal from the balance sheet. This would ensure compliance with the Auditor General's recommendations. However, we also believe that this issue is closely related to the accounting treatment of physical assets and that further

study is needed to determine if the assets underlying these loans should appear on the balance sheet.

3. The accounting treatment of physical assets

As indicated earlier, physical assets in the form of highways, bridges, ferries, buildings and equipment have not been shown as assets on the balance sheet of the province. Their costs have been shown as expenditures as they are acquired. This treatment is in keeping with that followed by other provincial governments in Canada although, in some other jurisdictions, a clear distinction between capital asset expenditures and operating expenditures is made.

With the increasing interest in ensuring that the balance sheet of a public body correctly reflects all of its obligations and liabilities, there is a corresponding desire to give a better indication of the accumulated physical assets it owns. Inclusion of physical assets on the balance sheet would be in accordance with trends established by PSAAC recommendations. Public Sector Accounting Statement 2 issued by PSAAC states:

> *"Reporting the difference between the government's financial assets and liabilities, alone, is not sufficient to provide users with an adequate description of a government's financial condition...It would therefore be beneficial to report information in financial statements about acquired physical resources which have a useful life extending beyond the accounting period."*

PSAAC has also issued a Research Study which recommends that governments should account for and report physical assets. PSAAC has also recently begun a further project to determine how physical assets should be accounted for.

In addition, the Auditor General has recently recommended that the government's financial statements disclose information to describe a government's physical assets on hand and available for use.

In keeping with these recommendations and the increasing recognition that public debt is represented by significant physical resources which are consumed over time, we believe that the province should consider the capitalization of physical assets, starting with those which can be readily identified and for which values can be ascertained. The primary group of assets to which this applies is buildings and, to a lesser extent; computer equipment and vehicles. The government, through Crown corporations and various public bodies, has paid for a significant number of buildings. These include government office buildings, universities, hospitals and schools. We recommend that the depreciated value of these assets be recorded as assets in the government accounts and amortized over their useful lives.

Subsequently, as more information becomes available, government should consider the capitalization of other assets including highways, bridges and other equipment.

Until this action is taken we recommend, as a first step, that the government distinguish between operating and capital expenditures in its published reports (Estimates and Public Accounts) so that the amounts expended on physical assets are more visible.

Appendix C

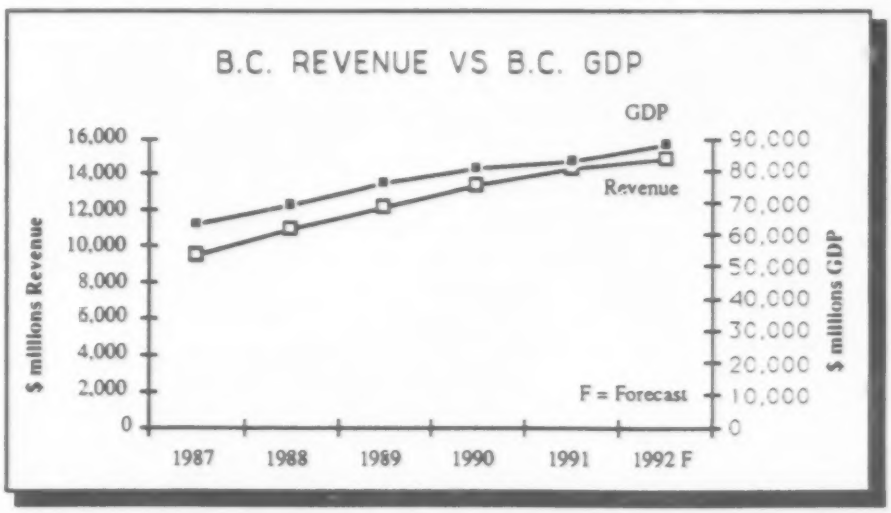
Changes in Revenue and Expenditures

Set out below are the major variables and the details of assumptions chosen for use as low, median and high changes in revenue and expenditures. For the fiscal year ending March 31, 1993, the forecast of various economic variables for the calendar year 1992 were used. Likewise, the forecast of economic variables for the calendar year 1993 were used for the analysis of possible outcomes of the fiscal year ending March 31, 1994.

A. Gross domestic product

Gross domestic product is a common indicator of goods and services produced within the province. Changes in revenue of the province have historically tracked closely to the changes in British Columbia's nominal gross domestic product. With the exception of transfers from the federal government, revenues are largely taxes which relate closely to economic activity in the province.

The following chart illustrates the correlation between gross domestic product and provincial revenue in British Columbia.



Ranges used for growth in gross domestic product

The following are the ranges we have employed for growth in gross domestic product:

Source	1993	Source	1994
High—Conference Board	4.1%	High—Royal Bank	4.0%
Median—Province of B.C.	3.2%	Median—Province of B.C.	3.5%
Low—B.C. Central C.U.	1.5%	Low—The WEFA Group	2.3%

B. Wage increases

Wages account for 53 per cent of government expenditures with the result that a one per cent increase in wages impacts provincial costs by approximately $88 million.

The following is the historical rate of increase in public sector wages for the years 1989 through 1991:

1989	1990	1991
7.6%	7.2%	7.2%

Ranges used for increase in wages

Few economic forecasters provide estimates of public sector wage increases, therefore, wage increases used are related to published forecasts of private sector average increases for the Province of British Columbia. Recently, public sector wage increases have been higher than the private sector which could mean that future public sector increases will be at or below that of the private sector or public sector increases will range above those used in our calculations. The low range is estimated at British Columbia CPI.

Source	1993	Source	1994
High—B.C. Central C.U.	5.3%	High—Estimated	4.0%
Median—WEFA	4.4%	Median—WEFA	3.2%
Low—B.C. CPI	2.0%	Low—Royal Bank CPI	3.1%

C. Consumer price index

Increases in non-salary expenditures relate to the increase in the price of goods. The consumer price index is a reliable source of that price change. The increase in the rate of growth in the consumer price index over the past three years is set out below:

1989	1990	1991
4.5%	5.5%	5.3%

Ranges used for consumer price index change

The following are the consumer price index changes forecast by various organizations which we have used for the purpose of our calculations:

Source	1993	Source	1994
High—B.C. Central C.U.	4.2%	High—T.D. Bank	3.8%
Median—T.D. Bank	3.5%	Median—Province of B.C.	3.2%
Low—Province of B.C.	2.0%	Low—Royal Bank	3.1%

D. Level of unemployment

Some expenditures of the province, like social welfare, are directly impacted by the level of unemployment within the province. For those expenditures where that is a factor, the unemployment rate has been used.

The historical experience in unemployment rate is set out below:

1989	1990	1991
9.1%	8.3%	9.9%

Ranges of unemployment level

Source	1993	Source	1994
High—Province of B.C.	10.4%	High—Province of B.C.	10.3%
Median—Conference Board	9.8%	Median—Conference Board	9.5%
Low—T.D. Bank	9.3%	Low—Scotia Bank	8.6%

E. Population growth

Population growth has an impact on the utilization of many services provided by the province. Expenditures on health, education and social services are impacted by growth in the population. The following chart sets out the rate of population growth over the last three years.

1989	1990	1991
2.3%	2.6%	2.8%

Rate of population growth

For the purposes of our analysis of possible outcomes, we have used a rate of population growth for the province of 2.5 per cent. Because the rate of growth has been steady over recent years, we have not varied the rate of growth between scenarios.

F. Interest rates

Deficit financing leads to a significant growth in provincial debt and related debt service costs. The level of interest rate has a direct impact on the expenditure for interest to service that debt.

Ranges of interest rate

The following are the ranges of interest rate used in our calculations:

Source	1993	Source	1994
High	10.10%	High—RBC Dominion Sec.	11.10%
Median	9.40%	Median	9.35%
Low—Wood Gundy	8.70%	Low—Wood Gundy	8.60%

PROVINCE OF BRITISH COLUMBIA
POSSIBLE INCREASES IN REVENUE

Increases in revenue:

Revenue sources include taxation, natural resources, contributions from government corporations, federal government transfers and other revenue sources. Historically, there has been a close relationship between growth in nominal GDP and growth in government revenues. A 1% change in GDP will approximately result in a $140 million change in revenue. Due to federal government transfers growing much more slowly than GDP, this relationship has changed in recent years so that total revenue is now less sensitive to changes in GDP. Revenue includes privatization benefits.

Possible increases in revenue

GDP	Year Ending March 31, 1993 ($ Millions)			Year Ending March 31, 1994 ($ Millions)		
	Low	Median	High	Low	Median	High
1.50%	$601			$739		
3.20%		$839			$921	
4.10%			$965			$998
	$601	$839	$965	$739	$921	$998

PROVINCE OF BRITISH COLUMBIA
POSSIBLE INCREASES IN EXPENDITURES

Transportation

New construction and rehabilitation of the existing road network is largely discretionary, therefore, the high and low possible outcomes for Transportation are adjusted by an estimate of capital expenditures. Other costs, such as ongoing maintenance, administration and other ministry costs, increase with increases in salaries and inflation.

COST DRIVERS		Year Ending March 31, 1993 ($ Millions)			COST DRIVERS		Year Ending March 31, 1994 ($ Millions)		
Wages	CPI	Low	Median	High	Wages	CPI	Low	Median	High
3.00%	2.00%	$(116)			3.10%	3.10%	$43		
4.40%	3.50%		$184		3.20%	3.20%		143	
5.30%	4.20%			$590	4.00%	3.80%			249
		$(116)	$184	$590			$43	$143	$249

PROVINCE OF BRITISH COLUMBIA
POSSIBLE INCREASES IN EXPENDITURES

Health

Expenditures for health care are primarily driven by wage increases. For every dollar of expenditure in Health, 80 cents ultimately goes to wages, salaries, physicians' fees and benefits. Each percentage point in health sector wages costs approximately $43 million. Non-wage related expenses vary generally with the rate of inflation.

COST DRIVERS		Year Ending March 31, 1993 ($ Millions)		
Wages	CPI	Low	Median	High
3.00%	2.00%	$212		
4.40%	3.50%		$295	
5.30%	4.20%			$346
		$212	$295	$346

COST DRIVERS		Year Ending March 31, 1994 ($ Millions)		
Wages	CPI	Low	Median	High
3.10%	3.10%	$340		
3.20%	3.20%		$351	
4.00%	3.80%			$399
		$340	$351	$399

PROVINCE OF BRITISH COLUMBIA
POSSIBLE INCREASES IN EXPENDITURES

Education

Education expenses are driven by teachers' and faculties' salaries, associated benefits, classroom size and population growth. Approximately 85 per cent of education expenses are salaries. Non-salary costs are driven by inflation.

COST DRIVERS		Year Ending March 31, 1993 ($ Millions)			COST DRIVERS		Year Ending March 31, 1994 ($ Millions)		
Wages	CPI	Low	Median	High	Wages	CPI	Low	Median	High
3.00%	2.00%	$254			3.10%	3.10%	$260		
4.40%	3.50%		$324		3.20%	3.20%		$268	
5.30%	4.20%			$366	4.00%	3.80%			$309
		$214	$284	$326			$260	$268	$309

PROVINCE OF BRITISH COLUMBIA
POSSIBLE INCREASES IN EXPENDITURES

Social services

Approximately 60 per cent of the expenditures made for social services go to income assistance and related program costs. The cost of providing income assistance depends on the unemployment level, population growth and the rate of inflation. The costs of providing other programs through social service are generally related to the rate of inflation and the absorption rate of new programs.

COST DRIVERS		Year Ending March 31, 1993 ($ Millions)		
Unemp	CPI	Low	Median	High
9.30%	2.00%	$350		
9.80%	3.50%		$392	
10.4%	4.20%			$408
		$350	$392	$408

COST DRIVERS		Year Ending March 31, 1994 ($ Millions)		
Unemp	CPI	Low	Median	High
8.60%	3.10%	$283		
9.50%	3.20%		$301	
10.3%	3.80%			$333
		$283	$301	$333

PROVINCE OF BRITISH COLUMBIA
POSSIBLE INCREASES IN EXPENDITURES

Other expenditures

Management of public funds and debt comprise approximately 25 per cent of other expenditures over the next two years. The remaining costs in this category are largely related to the increases in public sector salary increases and the rate of inflation. The increase in 1992/93 is relatively small due to a large loan provision in this category incurred during 1991/92.

COST DRIVERS			Year Ending March 31, 1993 ($ Millions)			COSTDRIVERS			Year Ending March 31, 1994 ($ Millions)		
Interest	Wages	CPI	Low	Median	High	Interest	Wages	CPI	Low	Median	High
8.00%	3.00%	2.00%	$(85)			8.50%	3.10%	3.10%	$324		
9.25%	4.40%	3.50%		$(38)		9.25%	3.20%	3.20%		$335	
10.5%	5.30%	4.20%			$(5)	11.0%	4.00%	3.80%			$361
			$(88)	$(38)	$(5)				$324	$335	$361
Total Change in Expenditures			$614	$1,156	$1,705				$1,250	$1,398	$1,651

Appendix D

Entities Reviewed

1. Aboriginal Affairs
2. Advanced Education, Training and Technology
3. Agriculture Fisheries and Food
4. Attorney General
5. B.C. Assessment Authority
6. B.C. Building Corporation
7. B.C. Ferry Corporation
8. B.C. Hazardous Waste Management Corporation
9. B.C. Housing Management Commission
10. B.C. Hydro
11. B.C. Lottery Corporation
12. B.C. Pavilion Corporation
13. B.C. Petroleum Corporation
14. B.C. Rail
15. B.C. Systems Corporation
16. B.C. Trade Development Corporation
17. B.C. Transit
18. Credit Union Deposit Insurance Corporation
19. Criminal Injuries Compensation Board
20. Discovery Foundation
21. Duke Point Development Ltd.
22. Economic Development, Small Business and Trade
23. Education (Ministry Responsible for Multiculturalism and Human Rights)
24. Energy, Mines and Petroleum Resources
25. Environment, Lands and Parks
26. Finance
27. Financing Authorities
28. Forests
29. Government Services
30. Health
31. Insurance Corporation of B.C.
32. Job Protection Commission
33. KAON
34. Labour and Consumer Affairs
35. Liquor Distribution Branch
36. Lottery Grants Program
37. Municipal Affairs, Recreation and Housing
38. Pacific National Exhibition
39. Provincial Rental Housing Corporation
40. Science Council of B.C.
41. Social Services
42. Terry Fox Medical Resource Foundation
43. Tourism and Culture
44. Transportation and Highways
45. Women's Equality Ministry
46. Workers' Compensation Board
47. Year of Music Society